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A SHORT HISTORY OF INVESTMENT

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BY

PERCY RIPLEY

"It may be true, as the Socialists affirm, that social service is a higher ideal than private money-making; but all history is a *pis aller*. We must take human nature as we find it, and make the best of the motives which regulate the conduct of ordinary men. . . . The ownership of property, though sometimes demoralizing, is most generally educative, it fosters a cluster of virtues and interests of its own, it heightens and enriches personality by the span of experience and weight of responsibilities which it brings in its train. We are not aware that money-making is bad for the character. On the contrary, it is for the normal man the most harmless employment to which he can devote himself."

—THE RIGHT HON. H. A. L. FISHER
"*The Ethics of Capitalism*," *Lloyds Bank Review*,
April, 1933.

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TO SIR GEORGE PAISH
FRIEND AND COUNSELLOR
OF MANY YEARS

PREFACE

BIBLIOGRAPHIES are sometimes almost as lengthy as the book itself. That is an honest practice, because it leaves the reader under no impression that he is about to peruse highly original work. I should like to be as honest; but, on the other hand, I should be sorry to cause anyone to read all the books, pamphlets, State publications, etc., from which I have helped myself. But at the risk of being invidious I would specially mention Professor W. R. Scott's *Joint Stock Companies to* 1720, and I must pay tribute to *The Economist* and *The Statist.*

I am indebted to Sir George Paish for permission to reproduce his calculations of Britain's overseas investments at the end of 1913, and to Dr. Fitzgerald for the loan of certain documents. I should like also to express my appreciation of the excellent service of the Kent County Library.

P. R.

FAIRFAX
CHISLEHURST,
December, 1933

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A SHORT HISTORY OF INVESTMENT

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DISTINCTIONS AND DEFINITIONS

THE first chapter of a book of this kind must almost inevitably open with reference to such matters as preliminary distinctions and definitions, an outlining of the scope of the inquiries which are to be undertaken, and, in general, with telling a reader what he may expect to derive if he has the patience to persevere to the end. To begin with, then, the book is not a history of all the forms of money-lending; therefore whosoever is eager to study the growth of facilities for accommodation granted by the individual in friendly or professional capacity, by pawnbroker or goldsmith, should turn elsewhere; herein occur only passing and incidental references to the development of the art and craft of advancing on note of hand or on the family plate. The exclusion is not made without some faint regret on the part of the writer. His Puritan upbringing fits him for tasks like to a moralizing over "the virtuous Brutus" lending money in Cyprus at 8 and 40 per cent; a roving tendency transmitted spiritually from his poaching gipsy ancestors urges him to move leisurely

through the give and take of the centuries until he arrives, a welcome guest, in the modern bank parlour, where the mechanism for the granting or refusing of overdrafts is skilfully operated. It would be an exquisite pilgrimage, and were the writer less rigid of principle he might contend that the difference between the investment of money and the lending of money is small enough to justify the peregrination. But he has reluctantly to acknowledge the promptings of conscience and admit that although investment and money-lending are similar in quintessence, they are dissimilar in their embodiments and in the effects which they have upon the multifarious activities of men. Let it be understood also before we are really about our business, that neither is the private purchase of land or property the theme pursued. Admittedly, this comes within the category of investment and demands all the respect accorded to tradition; for it is one of the most ancient ways of utilizing money or the equivalent thereof. It may be recalled, to cite a memorable instance, that Abraham weighed out to Ephron four hundred shekels of silver in payment for a field. The land was required for the making of a burial place, and the transaction is therefore quietly away from the ordinary traffic of men. Nevertheless, the story of the acquisition suggests that the practice of putting capital into the safeguarding of earth was well established in the days of Israel's great patriarch, though the times were nomadic and the caravans moved from place to place. To your ghostly tents, O vanished Israelites; to your subject, O writer!

So be it. Our paramount concern will be with the use of money or credit for the acquiring of stocks or shares. Initially, the treatment is of the emergence of an idea and the gradual removal of hindrances to its development. Economic and financial theory and practice, in so far as they bear upon the nature and value of investments, are

subsequently dealt with at length, while considerable attention is also devoted to the structure and organization of various forms of capitalistic enterprise. The immediate aim is to deal briefly with origins.

Past Civilizations: The First Adventurers

It is not to be supposed that past civilizations were unacquainted with associations formed to earn profits and to distribute the gains among members. Lydia had its coinage seven hundred years before the coming of Christ, Alexander dispersed the bank reserves of Persia, and Pompei is alleged to have its ruins of a Stock Exchange. These things suggest that the pooling of financial resources was practised a long time ago. The suggestion recognized, the comment should perhaps be made that the existence of a national currency is not an infallible sign of the corporate use of money; at any rate, so little data is available upon the matter as a whole that any attempt to reconstruct the business arrangements of those remote times could only be conjecture. It may be doubted whether diligent research of the expert would result in discovery of any monetary or kindred experiment wherein are lessons applicable to our own day and generation.

More than twelve hundred years of the Christian era elapsed before there came into being an unmistakable forerunner of the joint stock enterprise with which we are familiar. In the middle of the thirteenth century the Burgundy Society of Adventurers bound themselves to share the proceeds of a common colonization and trade. The Florence of the fourteenth century with its highly developed banking system and vast commerce might possibly have known a number of similar concerns, and so might Genoa at the beginning of the fifteenth, in view of the existence there of the powerful Bank of St. George. It is conceivable that the great expansion of mining of

precious metals which occurred in Bohemia and elsewhere about this time may have caused the formation of syndicates. Certainly, three hundred years or so passed before the adventurers of Burgundy had their purely English imitators and successors.

The Church and Interest

An explanation of the tardiness of this recognition in England of the benefits of employing capital co-operatively and on a large scale is to be found in the fact that the taking of interest was condemned by the Church and the State, condemnation by the former being the more consistent and emphatic, which is not to be wondered at seeing that kings and nobles were inveterate borrowers. Beyond this explanation, some allowance should be made for ill-defined or imperceptible factors, the combined operation of which delayed the arrival of widespread change in the popular mental attitude to money matters. This granted, it remains that as long as using money profitably was authoritatively deemed fatal to the prospects of salvation hereafter and was visited by severe earthly penalties in the cases of selected scapegoats, the conception of investment could not take shape in the hurly-burly of ordinary life. The possessors of cash or treasure who were prepared to risk their chances of future bliss and who were cunning or bold enough to evade or defy the law of the land were in a distinct minority compared with their fellows who also had riches but who did not dare lend in the absence of priestly sanction and legal approval.

Henry VIII: Legalizing "Usury"

Denial of the moral right to reap benefit from "usury" was a lingering doctrine of the medieval schoolmen and at its best may have represented a survival of the communistic teaching of the primitive Christians. It may also

have been an unreasoning reaction against extortion; additionally, the possibility cannot be summarily dismissed that bias against the Jews may have prevented a truly critical examination of the question. The Church's opposition to the lending of money even at a low rate of interest was ill-advised, but it should in fairness be mentioned that her leaders did not ban active partnership for material ends. Earning of profit by those actually engaged in the business was conceded as just. We can sympathize with this endeavour indissolubly to connect reward with labour. But the enforcement of the doctrine meant the drastic circumscription of economic activity. The financing of enterprise was made impossible except to a few persons in a privileged position and they were compelled to concentrate excessively. Whatever the deficiencies of the doctrine, the irony is unaffected that the rightfulness of taking interest should first be placed upon the statute book in the reign of Henry VIII, a monarch whose opinion upon moral questions commands no respect. There is, however, nothing to suggest that Henry VIII was a financial reformer, any more than there is to show that he was even superficially acquainted with the demands upon conduct made by that Faith of which he was the self-styled Defender. On the contrary, he debased the nation's currency in order to line his own pockets. The Reformation, of which Henry was the adopter and not the inspirer, caused a ferment of ideas; it was a period wherein, justifiably or unjustifiably, esteem of the purists upon usury, namely, of the occupants of religious houses, had sunk very low. Conditions were propitious for change in social and economic practices. Legalizing of interest in England synchronized with the Reformation; but the legalizing was the concrete expression of a tendency which had long been gathering strength. The inception of State modification of attitude toward the taking of interest can

certainly be dated a century and three quarters before the granting of imprimatur; in other words, well before the close of the thirteenth century when, during the reign of Edward III, a policy was enforced of expelling the Jews from England. The carrying out of this concession to popular hostility seems to have lacked little in ruthlessness; even so, it is probable that some members of a race uniquely resistant to the effects of persecution contrived to remain and carry on business. But there is no reason to doubt that Edward III's drastic decree destroyed the monopoly in England of money-lending by the Jews; from that time forth dislike of paying for financial services rendered could no longer have as a defence prejudice against a race specially fitted by its own troubled history to assess the margin of risk run in the provision of what was later to be known as capital, a convenient designation then unknown.

New Lenders to Old Borrowers

The business of lending money to the State or rather to the King for use at his indiscretion, since in those days the King and the State were virtually one as far as the spending of money was concerned, gradually passed into the hands of the Lombards, the Flemings, and a few London merchants. History does not record whether the kings of England obtained better terms from their new-found financial friends than they did from the Jews. A great Florentine firm failed fifty years or so after the making of its first loan to an English king; but we need scarcely suppose that the failure was attributable to half a century of misplaced generosity, not even though Edward III christened an English coin a Florence and never accorded such an honour to Hebrew. Indeed, the occasion of the failure was a financial disturbance affecting the whole of Florence. Possibly, this shaking of the opulent and

industrious Florentine Republic caused widespread disillusionment and questioning, especially as its eighty banks had dealings with almost the whole of Europe; it may have played a part in awakening English rulers to the desirability of their country being more self-reliant in financial matters. If we assume that this last was so, then we have also to recognize that the process operated for long within a narrow channel. It is true that from this time forth wealthy London citizens were increasingly called upon to replenish the treasuries of their gracious sovereigns. But nearly three hundred and fifty years passed after the Florentine collapse before a truly English system of finance was initiated, although little more than half of this time had gone when Queen Elizabeth had recourse to English commercial associations and so made a break in the history of English financial expediency.

A Sixteenth-century Landmark

In the middle of the sixteenth century, then, we have an important landmark in the use of money, namely, a statute authorizing and legalizing the standard rate of interest in England. The 10 per cent interest proclaimed as permissible contained no allowance for the varying degree of risks of lenders; the rigidity of the statute was thus in opposition to the economic law which eventually had to be recognized, that the tenable rate of interest for a loan bears a well-defined relation to the standing of the borrower and to the supply of cash or the equivalent of cash available for the satisfaction of borrowers' needs generally. Nevertheless, it should be gladly admitted that a legalized 10 per cent interest represented a great improvement upon the preceding theoretically perfect establishment of the virtue of no interest at all, the outcome of which prescription for the perfection of conduct was that no uniformity of practice prevailed, and furtive

wringing out of exorbitant charges for accommodation was frequent.

Cobwebs and Strong Breezes

This liberation of an economic idea from the thraldom of dogma and prejudice was not to be accomplished without a slight setback. The successor of the professedly pious Henry VIII was the genuinely religious boy King Edward VI, and in his short reign the economic moralists again asserted themselves. Consequently, the former ban upon the taking of interest was restored, even the acceptance of a nominal rate being forbidden by law. However, the cobwebs of the cloister could not survive the strong breezes of Elizabeth's adventurous times, and shortly after Bess came to power the rate of interest was once more legalized at 10 per cent, since when a lender has had the right to invoke the aid of the Courts in order to secure the observance of a contract entered into with a borrower. The State continued long after Elizabeth's sun had set to attempt to govern the rate of interest for loans, and at the beginning of the eighteenth century the rate of interest so authorized was 5 per cent, or half of what seemed fair one hundred and fifty years before. The implications of this fall should not be thought to be profound; as we have seen the change was artificially induced, the rate of interest stipulated by the State was never universally observed, and it was less observed in the reign of William and Mary than in the reign of Elizabeth. The foregoing are sufficient reasons for not attaching deep importance to the change.

It may be commented additionally that any examination of the degree of reality in the fall would have to take account of the alterations in the prices and consumption of particular commodities at the points of history mentioned.

Widening Financial Horizons

The conclusion of the matter, as far as this introductory chapter goes, is that the use of money before the Norman period was of too circumscribed a character to bear upon our theme, and, further, that the main concern of financial practice from the later Norman period until the time of Elizabeth was emancipation from the bondage imposed by an irrational doctrine. Substantial easing of the position was afforded, but not complete release, when an English queen herself showed no qualms about obtaining a very liberal return on the money she risked in trade, and whose temperament suggests that she would have been extremely annoyed if no return had been forthcoming. Incidentally, she could not have pleaded that she was employing her own hard-earned savings. Men, for a century and a half following this queenly departure, had not a wide range of choice when considering what to do with their money. But, as will be gathered from the pages immediately ensuing, financial horizons widened perceptibly in the days of outrageous freebooting and the writing of immortal drama.

CHAPTER II

WHICH TAKES US TO THE EARLY SEVENTEENTH CENTURY

ROUND about 1550—Regulated companies—The Merchants of the Hanse—Favours for foreigners—Seizing "the liberty"—Joint stock beginnings—The Russia and Africa companies—Queen Elizabeth as shareholder—Home industrial companies—The old lingers with the new—The East India Company—Narrow capital markets—Auditors, calls, discipline, and prayer

ELIZABETHAN days, being days of maritime and, to a much less extent, of industrial expansion, larger demands were made upon men and upon their money, and an outcome is that, with an unimportant reservation, the Elizabethan period is to be regarded as marking the inception of investment history in England. The reservation is that the desirability of organizing for purposes of commerce was recognized in practical manner before Elizabeth came to the throne in 1558, as can be seen from the fact that as far back as 1505 the Society of Merchant Adventurers obtained the grant of a Charter from Henry VII, while several similar companies were founded in 1553 or thereabouts, notably the Russia Company and the African Adventurers. Nevertheless, the whole range of the latter half of the sixteenth century should be considered as the field wherein a principle of common trading and sharing of profits, widespread beyond the former limitations of partnership, became firmly established in the English mind.

REGULATED COMPANIES

The Russia Company is usually accorded the honour of pioneer in English joint stock trading although, strictly speaking, other companies may have equal right to the position. Certainly, of the purely English companies the Society of Merchant Adventurers dates back the farthest;

but ownership of a security issued by the Society had no place in its original constitution. Members pledged themselves to observe rules designed to promote co-operative effort, but the management of the trading money of each member remained entirely his own affair. In other words, members agreed to regulate their acts so as not to injure one another; hence the Society, as initially planned, belonged to that type of association classified by economic historians as a Regulated Company.

The Merchants of the Hanse

The craft guilds, more concerned with questions of workmanship than the furtherance of trade, clearly were yet localized forerunners of the Regulated Companies. This kinship granted, it seems surprising that the idea of associable enterprise did not take sooner a more ambitious form among Englishmen. They had in their midst, from the Middle Ages onwards, German merchants who afforded a striking lesson of the advantages to be derived from combination. It is impossible to state exactly the year in which these merchants who settled in London during the tenth century elected their first Alderman and Court of Twelve to frame laws for the governance of the conduct of the business community over which they presided. We know, however, that such a Council existed when the Merchants of the Hanse, as they were called, obtained a Charter of Liberties from Henry III, midway in the thirteenth century. Therefore, upon the most moderate estimate, English merchants delayed for over two hundred and fifty years making a thorough attempt to emulate the corporate methods of their successful foreign rivals.

Favours for Foreigners

However, the English merchants were not entirely to blame; for they were severely handicapped by the fact

that foreigners long received preferential consideration from English kings, who expected to be adequately rewarded for the special indulgencies they conferred. Such was the case with the Merchants of the Staple, foreigners with headquarters in London and branches abroad, who in 1253 actually secured the passing of a statute prohibiting English merchants from carrying staple commodities out of the Realm. The statute was repealed rather more than a century later, when English traders were placed on the same footing as the Merchants of the Staple, and either at or about that time began to be admitted as members of that body.

Seizing "The Liberty"

But although English merchants were unfairly treated by their own monarchs until the year 1362, nearly a century and a half of equality between foreign merchant and English had passed when the Society of Merchant Adventurers obtained its Charter. Humanly enough, the infancy of the chartered Society of Merchant Adventurers appears to have been as much occupied by attempts on its part to thwart the Hanseatic community as by constructive effort. That foreign goods were being brought into England in foreign ships and foreign agricultural produce sold at a price uneconomic to the English farmer were strong causes for indignation in high quarters, if not in low. Consequently, the oft repeating of this grievance of the Adventurers and others resulted eventually in the Crown seizing "the liberty" of the Hanseatic merchants, which act meant that they were deprived of power to carry on their business, excepting under extreme disadvantages. This pleasant demonstration on behalf of commercial freedom took place in 1554; the Hanseatic merchants were allowed to retain their lands and buildings until nearly the end of the sixteenth century, when Elizabeth

decided to complete the chapter and took the properties into her own safe keeping.

Joint Stock Beginnings

Three or four years after the undermining of the power of the Hanseatic traders, the Society of Merchant Adventurers experienced the important development from Regulation to Joint Stock; that is, from an association binding members in general terms to protect and advance a common welfare to an association more specific of purpose and more approximating to a company as we now understand commercial and financial organizations. Members of the reformed Society held shares and received cash distributions upon those shares according to the profits earned collectively.

It is not within our province to recount the adventurous side of the history of the merchanting joint stock companies from the year 1553 onwards, even though the very titles of the companies are intriguing with suggestion of daring quests in then remote parts. Tyrannical czar and comparatively mild sultan were sought out to confer exclusive privileges on British traders, while from the coast of Guinea, as the fruits of less persuasive bargaining, came to England heavy cargoes of ivory and of gold. This brief paragraph must suffice to catch something of the quality of commerce in those exciting days when Drake tormented the Spaniards and when the Merchant Adventurers by privateering relieved a scarcely monotonous form of legitimate trade and were themselves pirated.

A large amount of detailed miscellaneous information concerning these early English companies can be obtained from the State papers of the time and from elsewhere; our particular task is to excerpt a few of the more significant of those items which illustrate the growth of conceptions of investment. The task so defined does not involve

mentioning every company formed in the last half of the sixteenth century or letting the imagination play in order to fill gaps in the history of the companies selected for our purpose. The first company chosen is a subsidiary of the Society of Merchant Adventurers previously mentioned, a subsidiary entitled The Merchant Adventurers of Newcastle-upon-Tyne. This example is interesting because the words "joint stock" are used in one of the company's documents dated 1554. That use gives us justification for dating the origin in England of this term, for although the parent Society of Merchant Adventurers was reconstituted a year before, we have no record that the change was to joint stock, although undoubtedly the old conception of regulation had greatly broadened, and whilst the Russia Company was definitely joint stock in 1553, the words were not actually used by it. The first printing of the word "capital" in England, in the meaning of money used in business, is said by investigators of the subject to date from fifteen years later; that use is not in company records; there the initial appearance of the word is at a much later date. However, it can for all practical purposes be said that the words joint stock and capital began their English careers in the early part of the second half of the sixteenth century. This is deserving of emphasis, because terms come into being in response to the word-hunger of humanity; the first, and perhaps rather casual, employment of terms, is an indication that tendencies hitherto submerged are gathering strength for increasing expression. We accept, then, the words joint stock and capital as having arisen to meet an economic need under the pressure of the same forces that compelled the word usury to be relegated to an archaism. Words having been given pride of place, our next step must almost inevitably be a recognition of statistical outcropping of the tendencies under review; that is to say, we must look a little at the growth of capitalizations.

The Russia and Africa Companies

We turn to the year 1553 also for an early example of these. The Russia Company, whose members, by the way, were still called adventurers, and not shareholders, in this year provided £6,000 of capital by calls of £25 on each share, which compares with the £5,000 capital of the African Adventurers formed in the same year. The Russia Company owned ships, the African Adventurers engaged for the voyage only; the former company was a continuous enterprise, the latter company was virtually re-formed with each voyage. Recapitalization of each venture, that is, each voyage as it took place, was much the more common practice at this time, and it was customary to number each issue of capital as First Joint Stock, Second Joint Stock, and so on. Unfortunately, renumbering was also used when a company was reconstructed after a lengthy existence; thus, for example, the Russia Company in the first thirty-three years of its life was reconstructed twice, and the third issue of capital was called Third Joint Stock. Apparent inconsistencies and contradictions abound at this stage of our inquiry, and we have to safeguard ourselves by bearing in mind that we are taking a broad view. This guiding principle accepted, it can be said that the comparatively enduring capital organization of the Russia Company was the forerunner of something destined to survive in English financial practice, while the method employed by the African Adventurers, although persisted in for long by these and other adventurers, was destined to disappear under the influence of the gradual rise of an English banking system which made easier the retention indefinitely of undistributed balances of profits. But rise of the banking system had not begun in the days which now claim our attention, days of which it cannot even be said that the goldsmiths' vaults were available as repositories of other people's treasures.

Queen Elizabeth as Shareholder

A characteristic of the trading organizations of this era is that each had a charter from the State granting a monopoly of trade within a certain territory or in certain commodities. Therefore, the State connection was close, and perhaps agreeably so when Elizabeth became interested in the African Adventurers and provided them with men-of-war convoys in return for a third share of the profits; but, as we shall see subsequently, the relationship was to bring its disadvantages. There can be no doubt, however, that the direct or indirect association of the State with these early enterprises facilitated the raising of capital by them.

Home Industrial Companies

The State was associated with the Mines Royal Society, which came into existence between 1560 and 1570, and which was one of the few companies formed within the sixteenth century for the development of home industry. This Society was granted the exclusive right to search for gold, silver, copper, and quicksilver in eight English counties and in the whole of Wales, the State to receive one-tenth royalty on the annual production. It is interesting from a capital point of view that the sum subscribed was much larger than had been provided for by any company previously, twenty-four shares being issued at an average price of £1,200 for each share. That English kings and queens had for centuries borrowed abroad makes the fact of ten of the shares being subscribed by German financiers less surprising than might otherwise have been the case; nevertheless, this sixteenth-century foreign participation in English joint stock enterprise will hardly have been expected.

Another company formed about this time was the Society of the Mineral and Battery Works which, after a

brief spell of acute rivalry with the Mines Royal Society to the extent of disregarding the latter's rights, moved into close association with that concern, so much so that the companies seem in some old State documents to be referred to as one. The capital of the Mineral and Battery Works amounted in 1568 to £7,200 in thirty-six shares. It is noteworthy that the company was a producing and a manufacturing body, mining zinc in Somerset and iron in Monmouthshire, drawing supplies of copper from the Mines Royal Society, and turning out brass wares from factories in London and Nottingham.

THE OLD LINGERS WITH THE NEW

Thus the inter-relating of differently originated joint stock companies was soon practised, and we have already seen that subsidiaries were formed by the first of the joint stock companies, namely, the Society of Merchant Adventurers, some years previously. The Russia Company, the Mines Royal Society, and the Society of Mineral and Battery Works also quickly became parent concerns. An examination of the capitalization and constitution of these minor subsidiaries is not material to our theme; some were maintained in existence for a lengthy period, others were rapidly abandoned. It is desirable, however, to bear in mind that although the financial technique of companies was primitive during the last half of the sixteenth century, the possibilities of joint stock enterprise were becoming increasingly apparent, and experiments in joint stock methods although few were of a basic kind. As might be expected, the old lingered with the new, and examples of the regulated type of company still survived, one of the most important being the Eastland Company, an association of cloth merchants dating from the beginning of the fifteenth century. Some companies were of an indeterminate character, alternating between the old

form of organization and the new. Such was the case with the Levant Company; consequently, doubt exists as to when in its career the company was regulated or joint stock. It was certainly the latter in 1605 when granted a permanent Charter to replace the temporary one bestowed twenty-four years earlier, although retaining a system of entrance fees for members. What was precisely the organization of this company in 1581 is of importance, because Elizabeth lent the company £40,000 in this year and an additional £40,000 was obtained from other sources. If we assume the company was joint stock at this time, and the balance of the evidence is that way, then the Levant Company trading in the produce of the Sultan of Turkey's curious dominion, has the honour of first using shareholders' capital in a truly grand manner.

The East India Company

Nineteen years later the East India Company was launched, and just before the close of the sixteenth century the sum of £30,000 had been subscribed as capital, representing part payments on account of shares of £200 each. The subscribed capital of the company, as a result of various financial adjustments, including the raising of the denomination of the shares to a denomination of £240 each, was more than doubled in the next two years. We meet here with one of those difficulties of exact classification which beset us at this early stage of our inquiries; for it was not until 1612 that the East India Company termed itself a joint stock concern, making in the following year an issue of capital called First Joint Stock. The difficulty is not one which need exasperate us; we may recognize that although the company was, from its inception, more of the joint stock type than the regulated, practices peculiar to the latter played a definite part in the first decade of the East India Company's history.

Therefore, the East India Company's retention for some time of a designation in the course of being rendered obsolete by its own growth is understandable.

The degree in which the East India Company was joint stock and the degree in which it was regulated during the first dozen years of its existence are questions over which only the academically minded will feel disposed to linger. We can, for our purpose, take the year in which the East India Company avowed itself as of the new order of commercial and industrial organizations as being a convenient time-mark in company history, a mark sixty years removed from the date of the formation of the first English joint stock company, namely, the Russia Company.

Narrow Capital Markets

This span of sixty years is one of which we must say that money was still adventured rather than invested; for even when money was used for the development of enterprises at home and not subject to the risks of winds and waves and corsairs, it was being used in a land without a banking system and where knowledge of industrial and financial technique was embryonic. Scarcely any freedom of capital movement existed. A person who wished to dispose of a share could not resort to a market; he was compelled to negotiate with some one who was already a shareholder, or who from some other reason had a close acquaintance with the company concerned. Strange though it seems, the idea of increasing the capital of companies by adding to the number of their shares was not as yet perceived, and when companies required additional capital, shareholders were made liable for further amounts on the shares they already held. The result was that the denominations of shares rose to prohibitive levels and caused some shareholders to endeavour to sell fractions of their holdings.

It is evident that under these circumstances the growth

of joint stock enterprises could proceed but slowly. We find, too, that the management as well as the capital arrangements of the companies was cumbrous. The affairs of the East India Company and the Levant Company, to take the two most important examples, were administered by a Governor, a Deputy, and twenty-four Assistants. The appointment of ten auditors to the East India Company may not have been an excessive proceeding; for the days of independent auditors had not arrived, and auditors had to check one another as well as the company's accounts. Possibly, the strictly Regulated Companies elected their auditors similarly, but the East India Company records are the first to show the election of auditors as depending upon the popular vote; four of the East India Company's auditors were appointed by special committees of those interested in the company, and the remaining six elected by the "generality" of the shareholders.

Auditors, Calls, Discipline, and Prayer

One of the things which the East India Company soon established in joint stock practice was the right to sue shareholders who failed to pay calls on their shares. The company had not been in existence much more than a year before it obtained powers from the Lords of the Privy Council to this end, and warrants were issued against defaulters. Whether Balance Sheets were issued regularly in these days we do not know; certainly meetings of shareholders were frequent. Something of the old guild discipline was enforced at these gatherings; shareholders could be fined for a wide range of offences, including interruptions, private whisperings, and even for leaving the meetings, or Courts as they were termed, without permission. Those who did not pay the fines ran the risk of imprisonment. The Courts of Companies frequently

opened with prayer; the Governor of the Levant Company was presented with a Bible as one of the symbols of his office. Probably, many of the dignitaries of the Church still believed that the taking of interest was highly immoral; the city layman's conscience was not so troubled. It would be uncharitable to assume that the worthy aldermen and others who financed these early companies believed that religious observance and large profits went together; but they saw no reason to separate religion from business, and if they often confused business with religion, ecclesiastics who have made religion a business were not unknown in those or later days.

CHAPTER III

FROM JAMES I TO CHARLES II'S ARRIVAL

1612—Handsome dividends—Parliament and national expenditure—The commercial intrusions of James I—New companies—Sale by candle—1620 and a business crisis—Recovery and Dutch liveliness—1625 and Charles I—Bolder joint stock notions—Regal honesty—1642 and civil war—The East India United Joint Stock—A hard-pressed Commonwealth—Charles II arrives

WE start this, the third chapter of our inquiries, at the year 1612, nine years after James I had come to the throne and three years after the formation of the Bank of Amsterdam. James I was much less adventurously minded than Elizabeth had been, and, this being so, we shall not expect daring initiative on the part of her successor. But although commercial enterprise in the reign of James had not the advantage of an alertly-sympathetic ruling monarch, peace had been concluded with the Spaniards and, nominally at any rate, Britain was in amicable relationship with the rest of the world. It was a handicap that James was unwilling to follow the practice of Elizabeth in lending men-of-war as convoys for merchant fleets; for a good deal of harrying was done by the Portuguese and others. However, stout resistance and more was offered to would-be marauders by the armed merchantmen of the Companies, and therefore the lack of James's naval support did not prove overwhelmingly serious. Commerce may not have thrived as it should have done, but by the test of profits the leading companies had little cause for complaint. The East India Company in the years round about 1612 was earning from 121 per cent to nearly twice as much, and the Russia Company paid 90 per cent for that year.

The National Expenditure

But the main factor which was to influence the growth of British commerce at this stage was not the somewhat indifferent external policy of James I. The steady disintegration of the nation's finances was much more relevant. Anything which approached a system of national finance had yet to be reached in Britain; Parliament had little control over expenditure, and in the next reign was to have far less; how and where the nation's revenue went no one knew, and rising deficits were bridged by resort to expediencies. The expenditure of the nation in peace was heavier than that of the nation in war, and there was nothing to show for the additional outlay. In order to replenish the Exchequer, James I, or his advisers, conceived the idea of making trade increasingly consist of monopolies. Sundry persons were granted the exclusive right to manufacture certain goods or to use alleged inventions, the Crown to receive handsome royalties or other remuneration. The practical application of the patent rights proved in many cases to be impossible, and the Crown's anticipated receipts therefrom did not mature; in other instances the granting of monopolies led to the charging of extortionate prices or shortage of supplies. Naturally, public outcry was great, and the Crown modified its policy of endeavouring to cover up unsound national finance by the aid of profits from the sale of privileges. It was not until 1617, however, that James really appreciated that State interference with freedom of trade was liable to be injurious, both to his own well-being and to that of his people. He had suspended four years previously the Charter of the Society of Merchant Adventurers, and had given exclusive rights in the dyeing and handling of cloth to a newly-promoted concern, whose sponsors claimed ability to earn vast profits, from which the Crown was to receive £300,000 a year. The expectations of the

optimistic promoters of the new concern were not fulfilled. James I was bribed by the anxious controllers of the Company who saw their hopes vanishing; but in vain. A year after James accepted a ewer of gold the concern was dissolved and the Society of Merchant Adventurers restored to its former position. Meanwhile, as a result of incompetent direction, the cloth trade of England had seriously declined.

New Companies: Sale by Candle

New companies formed in the reign of James I included two Virginia companies, the Ulster Company, the Bermuda Company, the Second Guinea Company, and the New River Company, the last being the first joint stock public utility company in Britain. The fact that these companies and a few other minor ones were formed may be noted as an indication of expanding corporate activity, but there are no special features in connection with them which need command our further attention at the moment. Our purpose is best immediately served by a consideration of developments with regard to what was to prove the greatest of the concerns, namely, the East India Company. We have already seen that the word capital in the sense of a stock of money was known to a limited circle in Elizabethan England, but it is not until 1614 that we find the word appearing in the record books of a company and meaning share capital as we now understand the term. The East India Company has the honour of this record. It should be remarked that distinctions between different classes of capital had yet to arise, and the reader, until he is warned to do otherwise, can take the word stock as the equivalent of share. The East India Company in the same year as it fostered the use of the word capital took steps to broaden facilities for the sale and purchase of its stock, and offered its stock by auction through a special Court of

Sale, the method of auction being the ancient one of inviting bids all the while an inch of candle burned. Whether shareholders who wished to dispose of stock could use the Court of Sale or whether the auction was only for new issues by the company is not clear; certainly only existing shareholders were allowed to bid for stock. Two years later the company altered the rules of the auctions and permitted anyone, whether a shareholder or not, to bid for the stock of the company when it was thus offered for sale. The negotiability of stock widened considerably from the date of this historic auction, although it was not until thirty years later that the beginnings of an English banking system became apparent, and the century had nearly run its course before alley trading in stocks foreshadowed the emergence of the London Stock Exchange.

1620 and a Business Crisis

So far the difficulties of companies had been chiefly those which proceeded from imperfect organization, an excessive patronage on the part of the State, and the risks of climate and plunderings, the few home industrial companies being free from the last. The year 1620 brought a new form of trial, namely, a commercial crisis accompanied by heavy falls in the prices of commodities. Commercial depressions had been experienced frequently before the seventeenth century, but the one which began in 1620 was the first to affect what were virtually public companies with numerous shareholders, and employing large amounts of capital. The East India Company at this time had nearly a thousand shareholders and a subscribed joint stock of £1,629,000. Causes of the crisis were diligently sought, and there was no scarcity of pamphleteers to air their views. The explanation most favoured was that of a shortage of money. It is reasonable to

suppose the currency system was at fault, particularly as the supplementing of the purchasing power of money by the judicious creation of credit was then unforeseen, let alone practised; but as also knowledge of the principles of finance and commerce generally was scanty there must have been ill-adjustment in many directions.

Recovery and Dutch Liveliness

The commercial depression lasted for several years, during which the East India Company, the African Adventurers, the Russia Company, and the Society of Merchant Adventurers all fared extremely badly. It would seem that the utmost depth of the depression was reached in 1622; for in that year cloth was reported as almost valueless in some districts of England. A decided reaction occurred in 1625 and values rose sharply, especially of land in the City of London. Yet while prosperity was in some measure regained another disturbing factor began to make itself felt, namely, foreign competition. This had never been absent since the first days of the English Companies, but it was now becoming intensified. The Dutch, like the English, were not at war in the first quarter of the seventeenth century. One result of their peaceful energies was the formation of the Dutch East India Company, an amalgamation of several formerly separate concerns; another was the formation in Holland of a powerful bank giving special attention to the financing of foreign trade. The Russia Company had already found itself ousted from Russia at the instigation of Dutch merchants and, turning to whale hunting, clashed with the Dutch in Greenland. An attempt had been made by the English East India Company to conclude an agreement with its Dutch rival, but the Dutch Company was too conscious of growing strength to desire any sharing of territory or spoils.

Charles I Begins His Reign: Bolder Joint Stock Notions

The rivalry with the Dutch was to become more acute as the century passed, but again it has to be remarked that deterioration of the English national finances was of greater consequence to the English companies. Charles I began his reign in 1625; where James had committed financial sins, Charles repeated the offences on a greater scale, and, additionally, perpetrated his own newly-invented excesses. The first few years of Charles's reign were not unpromising commercially. Colonization of New England went forward, as did also the development of plantations in the West Indies. Bolder ideas were expressed in joint stock undertakings, the most noteworthy example being the formation of the Society of the Fishery of Great Britain and Ireland. This Society, incorporated in 1632, had a capital of £167,000; it engaged in the catching and home marketing and exporting of fish, and controlled several unincorporated units. Charles, however, was finding the pleasures of Court expensive, and he had no intention of cutting down his own indulgencies or those of his favourites. The imposition of heavy royalties on gun-powder and playing cards wrought no great harm, and may have prevented some persons from ending their days by explosions or duels. But the range of the royalties was extended, and the discreditable monopoly practices of James exceeded. It remained for Charles to repeat the mistake that James made with the Society of Merchant Adventurers, and in 1635 he authorized the formation of a concern to compete with the East India Company, from which concern he was to receive a liberal share of the profits. This concern, originating at the Court, and known as the Courtiens' Association, was unscrupulous in its activities abroad, and was probably no better at home. Charles's next move was to endeavour to get his nominees

appointed to important posts of companies, and, on the shareholders of the Society of Merchant Adventurers declining by vote to assent to such a course, he forbade the use of a ballot box at company meetings in future. The condition of the country went from bad to worse, and by 1640 the fishery venture had failed, the Russia Company was in difficulties, the East India Company's profits severely reduced, and the much-vaunted Courtiens' Association in a hopeless plight. Charles, having exhausted his credit everywhere, purloined the property of goldsmiths and merchants lodged in the Mint, and later helped himself to the East India Company's stocks of pepper.

Civil War

We have to sojourn a little longer in the troubled political and religious atmosphere of the middle of the seventeenth century. Charles's peculiar ideas of financial honesty plainly were not of a kind to inspire confidence in the commercial community, and it is not surprising that business waned in 1640. The struggle between Parliament and King was beginning, and early in the year Pym had made his famous declaration that "The powers of Parliament are to the body politic as the rational faculties of the soul to man." Two years later the country was at civil war, and no spare energy was available for industrial and commercial development. However, we have to notice two facts of this period, one ironic and the other economic. The first is that several of the companies with which Charles had sought to tamper advanced sums to help the Parliamentary side; the second is that during the Civil War the foundations of English banking were laid, for we find the goldsmiths then inviting the deposit of money to be obtainable on demand.

The East India United Joint Stock—A Hard-pressed Commonwealth—Charles II Arrives

The Civil War ended in 1646, and the Long Parliament of Cromwell was dissolved in 1653. These years were not conspicuous for joint stock enterprise; the outstanding event in this connection was the amalgamation of the Courtiens' Association with the East India Company, capital for this and for the general purposes of the East India Company being obtained through an offer of what was called United Joint Stock. The sum actually offered for subscription was £300,000, but not all was taken up. It should be explained that the East India Company acquired the Courtiens' Association not by reason of the latter's prosperity but because the Association, failing of its initial programme, was committing malpractices in the East to the discredit of English enterprise generally. Six years after the conclusion of the Civil War Cromwell's Commonwealth became engaged in a naval war with the Dutch, which lasted until 1654. One result of this war was that the African Adventurers and other companies using sea-routes sustained severe losses. Whether or no the East India Company suffered heavily from depredations is not certain; the Company's history round about this time is chiefly a record of internal differences attributable, so it was alleged, to the disrupting influence of members of the old Courtiens' Association who had taken an interest in the New United Joint Stock. These differences were responsible for the East India Company temporarily losing its monopoly, the Commonwealth permitting ships independently owned to trade under licence with India. But this state of affairs did not last long. The Commonwealth in 1656 was so hard pressed financially that it beseeched a loan from the East India Company which, in return for the accommodation it granted, received

a new Charter from Cromwell. The national finances were in a more unsatisfactory condition than ever; ideas upon what were legitimate revenues and expenditures remained hazy, and to the effects of former carelessness and profligacy had to be added the expenses of war at home and abroad. Cromwell died in 1658, and in 1660 Charles II was crowned King of England. Charles was ushered in to the cry of "Retrenchment," and the outlay on the fighting forces was reduced.

CHAPTER IV

FROM THE RESTORATION TO THE ARRIVAL OF WILLIAM OF ORANGE

THE Third Guinea Company—1662 and a recognition of the limited liability principle—Plague and fire—The East India Company stops gaps—Household expenses—A dash by the Dutch and a lost opportunity—A "transport"—1670 and the Hudson's Bay Company—The Crown defaults and makes history in more ways than one—1675 and penny post—Banking and insurance—Joint stock supporters get an opening—A Scottish prospectus—The Commons' hold—James II and the East India Company—1689 and William of Orange

Two years after the Restoration, as Charles II's investiture as monarch was called, the Third Guinea Company came into existence. We can learn nothing of financial method from the constitution or conduct of the Company; but it is not irrelevant to take heed of the light which the concern throws on the moral ideas current at the time of its birth; for we are to see, soon after the turn of the seventeenth century, an outburst of corruption in the joint stock world, an outburst which had its origin in men's credulousness and rapacity. The latter vice was a besetting sin of the worthy gentlemen of the Third Guinea Company and of the Crown which granted a Charter to them. We are told the Company trafficked in human merchandise. It was a condition of the Charter that not less than 3,000 negroes should be shipped annually from Africa to the Indies. At the head of the Company was the Duke of York, a prominent Churchman. Thanks to raids on the Company's vessels by ships of other nations slaving did not prove profitable. Few at this distance will regret the Company's inauspicious start.

THE LIMITED LIABILITY PRINCIPLE EMERGES

It will have been gathered that the development of joint stock enterprise did not proceed inspiringly at the opening

of the reign of the second Charles. If the King's influence had been the determining factor, then all of the twenty-five years of his reign would have to be set down as barren of progress, financial or otherwise. The joint stock idea, however, had acquired a momentum from its now hundred years of life in England and its power could but be increasingly expressed. This being so, fevered activity broadened in spite of the boudoir outlook of the Head of the State.

The first financial gain to be recorded is the recognition in 1662 of the limited liability principle. It was conceded in that year that shareholders in several companies, including the East India, should not be responsible for the debts of the companies in the event of default of the latter. Actually the shareholders' liabilities were restricted to amounts due to be paid on their holdings. Nearly two hundred years were to elapse before this principle passed into the Common Law of the land and became applicable to all joint stock companies without exception. Nevertheless, it was in Charles's reign that the seed was sown, although the concession was then made in only a few cases.

Plague and Fire: A Dash by the Dutch

Whatever encouragement to trade there might have been at this time was soon checked by the Plague taking heavy toll of the inhabitants of London in 1665, and compelling people to desert the centres of business. The Plague was followed in the succeeding year by the Great Fire, which has been estimated to have done damage to the extent of over £10 millions. The East India Company was strong enough to increase its activities in the midst of general misfortune. Its power to withstand adversity was not wholly an advantage, because the Company was the more expected to stop gaps in the national finances

when the holes became uncomfortably large. In performance of this function the Company handed over £120,000 in 1666 and 1667. The need for the subsidizing of the Crown by a private company could not be entirely ascribed to inescapable national calamities, as is evidenced by the fact that in 1667 the expenses of the King's Household amounted to over £800,000. That year England was again at war with Holland and a slight revival of commercial activity was once more swiftly retarded by hostilities. On this occasion, the dash of the Dutch Fleet up the Medway caused financial panic, and heavy demands were made on the goldsmiths for payment of deposits left with them. Some of the deposits had been used for financing mercantile operations now badly hit by the war, and even the re-used deposits most favourably situated could not be quickly regained. Therefore, suspension of cash payments by the new profession of bankers was common. Only a year passed after the bold Dutch demonstration in the tributary of the Thames when, to use the words of Mr. G. M. Trevelyan, "an English diplomat in the Low Countries, Sir William Temple, negotiated with great skill the Triple Alliance of England, Holland, and Sweden to check the French advance on the Rhine and in the Spanish Netherlands." If England had steadily adhered to the policy, continues Mr. Trevelyan, she might have saved Europe an epoch of bloodshed. That is the first consideration; additionally, England would have benefited enormously from the commercial standpoint if she had been faithful to "the little Republic of merchants . . . poised between the sandbanks and the sea." But although probably desired by the plain folk of England, no enduring alliance with industrious Protestant Holland was possible while England had a King of "Roman Catholic and despotic proclivities," whose amours and indulgencies generally were a byword, whereas the First Magistrate

of Holland was renowned for the simplicity and austerity of his life. Three years passed and we discover Charles negotiating a secret alliance with France against Holland, in return for a cash payment and without the consent of the English Parliament.

A "Transport" Document: The Crown Defaults

However, the treaty with the Dutch ensured a brief spell of peace. An advance in the facilities for the selling of stock was witnessed in the year following, when the East India Company adopted a "transport" document, plainly the forerunner of the transfer form which has to be lodged with joint stock companies of the twentieth century. Whenever a sale of shares was made the "transport" opened with a declaration that "I . . . do sell and assign to . . ." This was in 1668; in 1670 occurred another outstanding event in joint stock history, namely, the forming of the Hudson's Bay Company, with an organization modelled closely on the lines of the East India Company. Seven days before Christmas, 1671, the Crown postponed payment of £1,328,000 borrowed from bankers and due to them. The money lent to the Crown by the bankers largely consisted of deposits made by ordinary citizens, and, consequently, the default of the Crown precipitated a financial crisis affecting the whole of the City of London and also beyond. We must mark well this incident, because the sum defaulted constitutes the beginning of the National Debt. It was subsequently recognized as an obligation of the English people and we shall follow in later pages the manner of its handling. Out of it sprang the system of English Government loans from the public and the provision of a highly important avenue of investment.

1675 and Penny Post: Banking and Insurance

By 1675 the nation had recuperated and fertility of industrial and commercial ideas was apparent, finding concrete expression eventually in such schemes as those for a London Penny Post and the provision of lamps on the outside of houses, by which rape oil illuminants London streets were then shadowily lit. Metallic money in circulation greatly increased as a result of expansion of coinage, and credit instruments in the shape of bankers' bills came into extensive use. The banking business was still mainly carried on by goldsmiths, but we find at this time a distinct tendency on the part of goldsmiths who accepted deposits to resort to the designation of bankers. Both the East India Company and the Royal African Company virtually acted as merchant bankers, accepting deposits for withdrawal at call or on notice, and it was evident that the conception of banking was entering vitally into the national life. In 1680 the declaration of a substantial dividend by the New River Company provided a stimulus to the forming of other water supply companies. It was in this year also that a fire insurance office was founded on a basis approximating to joint stock, a year further distinguished by the House of Commons refusing funds to pay the King's debts.

A Defence of Joint Stock Principles

About this time friction occurred between the Levant Company and the East India Company. We have referred previously to the difficulty of classifying the Levant Company; on the occasion of this dispute the Governor of the Levant Company claimed that it was conducted on regulated lines; he went further and attacked the notion of joint stock as injurious to the country. Possibly, the Levant Company was a regulated company at the time of

the dispute; that need not concern us, although we may note a certain contradictoriness in the fact that forty years previously the Levant Company had passed a resolution in favour of joint stock trading. We have to observe that the Levant Company's attack gave those in control of the East India Company the opportunity for making a spirited defence of joint stock principles, a defence which impressed a wide circle of commercial opinion. It was shown in this defence that trade with India had greatly increased since the East India Company had definitely adopted joint stock methods, and that this was to the benefit of England as a whole; as far as the condition of the Company was concerned, its ability to borrow at the low rate of 3 per cent testified remarkably to the soundness of its policy. Thereafter, the cause of the regulated companies which had long been waning suffered severe decline.

A Scottish Prospectus

Soon after this episode the documentary aids to investment received a notable addition by the issue of a prospectus appealing for subscriptions to stock. This document was circulated by the promoters of a Scottish undertaking formed to manufacture cloth, and, as far as is known, it is the first company prospectus to make an appearance in Britain. It has to be remarked that subscriptions would be accepted only from persons engaged in the cloth trade, and therefore we can hardly regard the prospectus as the medium for a public offer of stock; but this appeal for funds distinctly broadened financial practice as hitherto pursued and, the example given, it was not long before imitators perceived the inelastic elements and removed them. This Scottish venture was remarkable from other aspects; members of the governing body were all more obviously actual directors than was the case with contemporary English companies. Building up of financial strength

was the promoters' prime concern. Subscribers to the Scottish cloth company were not to expect any dividend for the first three years and only 5 per cent in each of the three years ensuing. It will be seen that Scottish financial conservatism is no recent product.

The Commons' Hold: James II and the East India Company: 1689 and William of Orange

The reign of Charles II ended with his death in February, 1685. "Bloody and disturbed" it was, as Mr. Trevelyan tells us, remembering the persecution of the Scottish Covenanters, and blemished by dissolute living in high quarters. Nevertheless, in spite of these things and Plague and Fire and War, England's wealth and foreign trade expanded. We have not yet arrived at the time when the nation's book-keeping is sufficiently clear and honest to indicate the real position of the National Debt at the beginning and at the end of Charles's regal and riotous quarter of a century. But there is no doubt that Parliament retained the closer control over the national expenditure which the Commons had stubbornly gained by Cromwell's aid, and the King's natural disposition to extravagance was allowed no easy rein. The task of delivering taxation from the demands of caprice and irresponsibility, although far from wholly accomplished, had made headway enough to permit of investment being less exposed than formerly to dangers arising from misappropriation of the nation's moneys. During the four years' reign of Charles II's successor, the normal activities of life were eclipsed by acute dissensions within the State. Rebellion signalized the arrival of James II, and speedily the efforts of the greater portion of the English people and a large portion of the Scottish were employed in endeavours to remove James from the throne. The

struggle ended by James fleeing to France in 1689 and William of Orange accepting an invitation to become King of England. A curious incident of these troublous days was the pledging of the support of the East India Company to James II by Sir Josiah Child, Governor of the Company, in face of the strong criticism of a minority of the shareholders, who were over-ruled and forced to dispose of their holdings. The shareholders thus defeated organized themselves in active opposition, and the effects of these dissensions were to be felt in various ways by the East India Company during the next twenty years of its history. While James was still in power the massacre of the Huguenots took place in France. A consequence of this outrage was that many Huguenot refugees fled to England. They brought with them a specialized skill which infused fresh life into the comparatively backward industries of England. This is all we can say from the business point of view with reference to the years from 1685 to 1689. But before the end of the century very significant financial innovations were to be made.

CHAPTER V

WILLIAM OF ORANGE—YEARS CROWDED WITH FINANCIAL INCIDENT

SALVING treasure—Companies in 1695—Scrip dividends—John Houghton's bulletin—The first joint stock bank—"Time bargains"—The Bank of England Charter—The State begins to borrow money publicly—Stockbrokers—Change Alley and "Jonathan's"—An Act largely dead—The new East India Company and the United—Corruption, great men, and currency reform—Exchequer Bills—The National Debt in 1701—The Darien Company—The Million Bank

HOLLAND had long been tolerant of the Jews, and upon the selection of William of Orange as King of England a number of the race came over from Amsterdam in search of opportunities for the exercise of their undoubted talents, reinforcing the few of their brethren who ventured back to England during the rule of Cromwell, although the ban on the Jews had not been officially removed. Those who now came from the great trading centre of Holland had the advantage of coming from a city much more advanced in financial technique than was the capital of England, and of arriving in times propitious for development of the gentle art of lending money and getting it back again. The year before William ascended the throne an English expedition had returned from salving treasure out of sunken ships, and so successful had it been that bullion and plate to the value of over £250,000 had been rescued from the deep. Popular acquaintance with this rich reward brought about many similar expeditions, most of which were organized on a joint stock basis. Partly as a consequence of this movement the number of British companies in existence had risen to nearly 150 by the end of 1695. Other factors had also fostered these forms of enterprise. The period was one of almost European war;

in numerous directions normal commercial pursuits were restricted and the possessors of money had to seek fresh outlets for the employment of their resources. Then, too, the Hudson's Bay Company and the Royal African Company were conspicuously prosperous in spite of the difficult times, as was also the East India Company until the challenge to its privileges became irresistible, leading eventually to the formation of a rival concern. All three companies had, round about 1690, distributed handsome scrip dividends, that is to say, they had given to their shareholders free additional shares. The kind of distribution then initiated has persisted to our own day. It has the advantage of nominally increasing the capital and so causing the rates of subsequent cash dividends to appear to be much less than actually the case, a consideration of importance when large profits are apt to be regarded enviously by multitudes who cannot directly participate in them.

John Houghton's Bulletin: The First Joint Stock Bank: "Time Bargains"

The increase of public interest in joint stock companies led to the publication of the approximate prices at which stocks could be bought and sold, the prices appearing in a list contained in a bulletin of miscellaneous commercial information issued at intervals by one John Houghton, whose list in 1694 comprised some fifty companies. This is the year in which the first English joint stock banking company was formed, namely, the Bank of England, and a year before the foundation of the Bank of Scotland. Naturally, the addition of Bank of England stock to the growing list of purchasable securities helped to attract still further attention to the City as a place for using money. The market for stocks acquired more definite character and securities were bought and sold as "time bargains";

that is to say, the cash for them was not paid immediately, but the parties concerned agreed to complete the settlement at a date specified, thus foreshadowing the days of account afterwards to be established by the Stock Exchange when that institution came into full existence.

The Bank of England Charter: The State Borrows Money Publicly: Stockbrokers

The Bank of England, as a condition of its Charter, had to lend to the Government the whole of its original capital of £1,200,000, on which it was to receive 8 per cent annually, plus an extra £4,000 each year for management. It is said that the suggestion of lending to the Government originated with William Paterson, the chief founder of the Bank; but it is not improbable that Charles Montague, the then Chancellor of the Exchequer, had a voice in the matter. The Bank was given the right to issue notes to the extent of its capital and to transact banking business generally. Two years prior to the foundation of the Bank of England the State began to borrow money publicly, instead of privately from merchants and goldsmiths as had been the custom to date. Its first experiment was by means of a so-called Tontine Loan for £1,000,000, but only one-tenth of the amount offered by the Government was subscribed. Clearly, the conditions of the Charter granted to the Bank of England meant that the State was borrowing from the public by means of the Bank. In the same year a State Lottery Loan of £1,000,000 was offered, followed in 1697 by one for £1,400,000. The increase in the number of companies, together with the issue of State Loans, brought into existence a large class of persons who earned a living by acting as intermediaries in the matter of buying and selling securities. These stockbrokers or stock jobbers, as they came to be called, met at first in the Royal Exchange, a building not intended for that purpose,

and whose regular fraternity of merchants were at first none too well disposed towards the new and noisy profession springing up in their midst. The annoyance must soon have been appeased, because by 1698 the dealers in stock found the Royal Exchange accommodation inadequate, and many of them betook themselves to Change Alley, nearby. A few of the brokers did not move until later, and those who did depart subsequently received an invitation from the Royal Exchange authorities to return; for it was now recognized that the stock dealer was destined to be a power in the land. The invitation was not accepted; when climatic conditions made open-air dealing in Change Alley too rigorous a business, dealers resorted to the warm interior of the famous coffee house known as "Jonathan's."

An Act Largely Dead

The City Corporation was early aware of the desirability of taking whatever steps were possible to ensure that persons handling large sums of other people's money should be of good character, and from 1st May, 1697, brokers had to obtain a licence from the Lord Mayor and Aldermen. The licence was granted only on evidence of honesty and good fame, and the broker was required to swear an oath promising that he would truly and faithfully execute and perform the office and employment of a broker. He promised to avoid fraud and collusion and generally to act according "to the tenour and purpose of the Act intituled to restrain the number and ill practice of Brokers and Jobbers." This Act, stipulated among other things, that a broker should not speculate on his own account; but as it was impossible to discover, except in flagrant instances, when a broker had done so, this part of the Act was a dead letter from the start, as, indeed, were other portions. Oaths were easily sworn and easily broken in those days.

It should not be assumed from the wording of the Act that the alignment of the functions of broker and jobber had already been determined. The Act was designed not alone to control dealers in securities but dealers in other things as well. Moreover, at this time the words stockbroker and stock jobber can be regarded as interchangeable, and the use of the one rather than of the other as a matter of preference and not an indication of the performance of separate duties, as was later to be the case. Discipline of brokers by the Corporation of the City of London was practised in gradually lessening fashion until 1886, when what was called the Brokers' Relief Act came into force. Thereafter the broker was subject to the general laws of the land and to the rules and regulations of the institution of which he was a member, but was freed from other special governance.

THE NEW EAST INDIA COMPANY AND THE UNITED

Meanwhile, the State was being drained by an unprecedented scale of expenditure on war, and it took the opportunity of replenishing its coffers by exploiting the situation caused by disruption within the East India Company. A monopoly of trade with India was conferred on those who subscribed to a loan of £2,000,000 to the State, the result being the formation of a new East India Company. It is a curious sidelight on the expediencies of national policy at this time that the original East India Company was permitted to subscribe to the loan, and we thus have the position of the original East India Company having a financial interest in the new opposing company. This is an early instance of the interlocking of the affairs of one company with another, a process which by the twentieth century was in many instances to reach a point almost defying analysis. It is not for us to pursue at length the various phases of the East India agitation,

since to do so would carry us too much into the domain of private and Parliamentary intrigue. But in order not to leave the matter inconclusive we may record that the end of the agitation occurred in 1708 when the rival concerns were amalgamated under the title of the United Company of Merchants Trading in the East Indies.

Corruption, Great Men, and Currency Reform: Exchequer Bills: National Debt in 1701

It would be difficult to find in English history a more extensive corruption than is to be found in the period with which we are now dealing. Members of Parliament and Members of the House of Lords took bribes as a matter of course. At least one of the Government Loans was the subject of a great fraud by a high official, and of all the loans raised in William's time a disappointing proportion actually reached the Exchequer. Indeed, it has been estimated that of the first £5,000,000 so raised only 50 per cent went into the Treasury. But the new ideas which had survived and expanded through a century of devastation, disease, and misrule, were not to decline or to be denied offspring merely because honest citizens were few and far between at the end of the seventeenth century. Great men were not entirely lacking. It was the time of Locke and Newton, and if William of Orange was not lovable he had solid virtues. Therefore, the period was one of broadening conceptions and some of the pressing financial problems were boldly handled, although others, by lack of knowledge or defect of moral courage, were not faced. Among the gains is to be counted a reform of the currency, which step involved the recoining of gold. The temporary withdrawal of gold from circulation led in 1696 to the issue of Exchequer Bills, by the use of which

was remedied the temporary deficiency of circulating media. These Bills were chiefly of £5 and £10 denomination, and were issued by the Government through the financiers, a swelling class playing an increasingly important part in the affairs of the nation and the scorn of the landed gentry, who were in a few years so largely to fall victims to the men whom they despised. The Bills, which were payable at a specified date, were more than a substitute for currency, however, because the Government paid interest at the rate of £4 11s. per cent per annum. It is evident the Government had found a useful way of borrowing for short periods, and in 1697 a further offer of Exchequer Bills was made, the interest being raised to £7 12s. per cent. The increased rate of interest may be in some degree an outcome of a decline in the Government's credit, but it also partly proceeded from an endeavour to make the Bills more acceptable—an endeavour which succeeded. It is hardly necessary to add that Governments early found tempting methods to persuade holders of Exchequer Bills to change into Loans repayable at a distant date, when it was either embarrassing or impolitic for the Governments to meet their obligations when they fell due. The very first issue of Exchequer Bills gave the holder the right to exchange into an "annuity" redeemable at a later date than the Exchequer Bills. By Lottery Loans and Exchequer Bills and the securing of funds through the Bank of England and East India issues, the foundations of the National Debt were being well if not truly laid. Various other minor loans were also raised and were mostly charged on the anticipated returns from duties on malt, coal, and other products, and on some anticipations of decidedly less common-sense nature; for possible sources of new taxation were feverishly canvassed at this time. The National Debt position at 31st December, 1701, was as follows.

Debt recognized as Perpetual	Principal	Annual Interest Required
	£	£
By means of stock of Bank of England	1,200,000	96,000
By means of stock of the (new) East India Company	2,000,000	160,000
The "Bankers' Debt" (of Charles II)	664,000	39,800
	3,864,000	295,800
Annuities and Debts charged on certain taxes with a view to redemption	9,861,000	853,000
Miscellaneous Debts having no such provision as those immediately above	2,669,000	162,000
	£16,394,000	£1,310,800

The average rate of interest paid on the total Debt was therefore a shade under 8 per cent per annum.

Some Reflections on the Figures

It must be borne in mind that the figures above can only be regarded as offering a broad indication of the state of the National Debt at the end of the seventeenth century; for the craft of accurate and even of honest book-keeping had yet to be acquired by Government officials. Presumably, the statement does not include sums borrowed for allegedly very short periods, such as the amounts secured from Exchequer Bills and Tallies, unless they have been included in the item of unfunded debts for which no redemption arrangements had been made. It will be noticed that well over a quarter of the Debt was acknowledged as of a permanent character; but figures for later years suggest that hardly any of the Debt was redeemed and strengthen the doubts previously mentioned concerning Exchequer Bills and Tallies. The sum of £664,000, which, although provided for, strictly speaking did not enter into the National Debt until 1705, represents

the compromise effected with regard to the £1,328,000 borrowed by Charles from bankers and on which he defaulted in 1671. The original holders of this debt and their descendants had to press their claims for thirty years before obtaining a settlement and had to be content at last with the State accepting liability for half the amount filched by Charles, the Government of William issuing requisite securities to bear interest at 6 per cent. Since the word tallies has been mentioned, these curiosities of Government finance should be defined. The tally was a stick with sides notched and serving as a receipt for money lent to the Government for a short period.

The Darien Company: The Million Bank

All of the reign of William III, which came to an end in 1702, was crowded with financial incident, both in Governmental and company finance. It was a time of many abortive schemes, including an attempt to float a rival concern to the Bank of England, shortly after the latter was founded. A minute episodic study is not our task; our concern is with a broadening stream, rather than with *debris* floating from time to time upon its surface. It should be mentioned, however, although the Company comes into the category of a colonizing venture by the Scottish nation as a whole, that within this period was formed the Darien Company which, after twelve years' existence, came to grief in 1707. Its failure had far-reaching political consequences; for, as Mr. Trevelyan tells us, Scotland learnt from the tragic failures of this settlement the bitter lesson that she had not the power and resources needed to open markets and found colonies for herself alone. Indeed, the failure prepared the way for the complete Union of Scotland and England, a development which involved the absorption of Scotland's Parliament and Privy Council into those of England. Until this Union

Scottish companies had been protected from the competition of English concerns; removal of this protection caused a crisis in Scottish finance and the collapse of several companies engaged in the manufacture of cloth. Less historically famous than the Darien scheme is the Million Bank, an English company started in the same year. The Million Bank was never a bank in the accepted sense of the word, and it soon became a company holding Government securities. As the first investment trust company the Million Bank must be accorded our recognition.

CHAPTER VI

FROM QUEEN ANNE TO THE SOUTH SEA FRENZY

The reign of Queen Anne—Joint stock capital—The first foreign loan—The delights of banking—The Bank of England and the Government—The South Sea Company—The art of reconstructing—The bull-calf—The famous hoax—1711 and expanding trade—Insurance companies—Beech nuts and preference capital—The first stock-broker's list—The Sinking Fund—Insurance companies again—1719 and a slackening of trade—The ideas of William Law—The South Sea frenzy—"The Bubble Act"—1722 and a Bank of England Reserve

As far as finance is concerned, Anne's dozen years as queen have no exciting flavour, unless we regard as such the liberal accumulating of Debt by the State. Scarcity of money and general business depression marked the first years of her rule, causing in 1704 suspension of payments by the Bank of Scotland and a substantial fall in the price of Bank of England stock. Disaffection in Scotland was partly responsible for this condition of affairs, but the main reason was the European War, which in one phase or another and at one place or another continued until the Treaty of Utrecht in 1713. Professor Scott has calculated that the total paid-up capital of English and Scottish companies soon after Anne came to the throne amounted to nearly £8½ millions. Many companies came to an end in the next few years as a result either of misfortune or mismanagement, but their disappearance did not prevent the capital invested in joint stock companies from doubling before George I became king. Really, however, as we shall see subsequently, the additional capital so created was much more for the use of the State than for private enterprise.

The First Foreign Loan

The depression did not lift until 1708, but the lack of money and confidence which prevailed thereto did not

stop the occurrence of an important financial event in the year 1706, namely, the flotation of an Eight Year Loan for £500,000 on behalf of the Emperor of Germany, secured on the revenues of Silesia and bearing interest at 8 per cent. This was the first foreign loan issued in England. The desirability of the Loan had been strongly urged by the Duke of Marlborough, then at the height of his popularity after the victories at Blenheim and Ramillies. That his victories did not bring peace until some years later is attributed by historians to the wrong-headedness of England's politicians.

The Bank of England and the Government

Although in 1705 and 1706 the annual dividend of the Bank of England was 7 per cent only, or 1 per cent less than received by the Bank on the capital it had lent to the State, the practice of banking was in several quarters regarded covetously; so much so, that the Sword Blade Company and the Mine Adventurers Company decided to add banking to their other activities and began to receive deposits, make advances, and issue notes. The taking of deposits by companies was no new thing, but plainly the issue of bank notes by any joint stock company which chose to do so could not be permitted by the Government. Accordingly, the Bank of England Charter was strengthened in 1708 and other corporate bodies were forbidden to issue notes, but the right was not withheld from partnerships comprising six persons or less. It will be gathered that the new Charter was inexpertly drawn; beyond allowing note issues by partnerships, nothing in the Charter prohibited joint stock companies carrying on banking as long as they did not issue notes. Rather more than a century was to elapse before joint stock companies availed themselves vigorously of the loophole, the delay being attributable to the fact that for long banking without issuing notes was deemed to be an unattractive pursuit.

The new Charter may have been imperfect, but it heightened the status of the Bank of England, and it is not surprising to find the Bank in the following year offering to lend the Government £400,000 free of interest. The Government felt that it was entitled to a larger sum but reluctantly accepted the £400,000. This meant that the Government had now borrowed £1,600,000 of Bank of England capital; the total interest was still to be £96,000 a year, or 6 per cent, against 8 per cent on the former amount of £1,200,000. The Bank of England was by no means as generous as it might seem. In the first place, the Bank obtained a handsome discount on the £400,000, by paying the nominal amount to a hungry Government somewhat before the date agreed; secondly, the Bank was given the business of circulating £2,500,000 of Exchequer Bills, on which it secured a profit. Growing responsibilities of the Bank demanded an increase of capital, and this was doubled, making the amount in issue £4,402,000. It should be remarked that the stock newly created was issued at a premium, £330,000 being realized by this action.

Sight of a monarch pouring away the nation's money in riotous living no longer confronts us; but we have the equally disturbing spectacle of a State borrowing lavishly and knowing little of how the money thus borrowed was spent. By 1710 interest on Exchequer Bills was in arrear, a fact which might have been alarming to statesmen if there had been no Bank of England. That convenient institution being obligingly to hand, the arrears of interest on Exchequer Bills, together with certain other Government debts then due, were by the Bank's aid converted into Permanent Debt; in other words, added to the amount which the Government already owed to the Bank of England. The sum so dealt with was £1,775,000, making the total Government Debt to the Bank £3,375,000. Once more the capital of the Bank was raised; this time

to £5,569,000. It would appear to be reassuring that no further increase in the Bank's capital took place for ten years. Unfortunately, the absence of increase is merely due to the Government easing in another direction its chronic impecuniosity.

The South Sea Company

In 1711 Government debts amounting to rather more than £9 millions were taken over by the newly-formed South Sea Company; that is to say, holders of these Government debts surrendered their securities and received South Sea Company stock in exchange. The idea of dealing with the debts in this fashion is said to have originated with Lord Oxford, a member of the then Government. The South Sea Company was to receive 6 per cent interest on the debts so transformed, and it was also granted a Charter giving it exclusive trading rights in the Pacific Ocean and elsewhere. All of the debts so taken over stood at heavy discounts in Change Alley; but they were valued at par for the purpose of the South Sea transaction. The working capital of the Company was to be provided by borrowing on the debts acquired. This gave to the Company power to borrow far more than could be remuneratively employed in ordinary trading; it was only a matter of time before the directors succumbed to the temptation to use unwisely the surplus credit to their hands. But we must not anticipate the fateful year 1720.

The Art of Reconstructing: The Bull-calf: The Famous Hoax: The Sun Fire Office

The art of reconstructing companies was by now well advanced, and 1711 witnessed this process with the Sword Blade Company and the Royal African Company. Many satirical pamphlets issued at this time depict unflatteringly the physiognomies and characters of stockbrokers; but

little light is thrown on the development of their business methods. Certainly, speculation was rampant and buying in the hope that stock would rise before payment was due a rapidly growing practice. Here we have the "bull," not yet perhaps much beyond the calf stage, but already adept at the spreading of rumours to further his own ends. The gentleman who sought to depress prices of stocks and who was afterwards honoured with the name of "bear" was not far behind. Indeed, the famous hoax wherein a messenger rode abroad proclaiming the death of Queen Anne while that lady was yet living is said to have been arranged by two of the leading lights of Change Alley, who, it was afterwards suspiciously recollected, were not averse from purchasing at bargain prices what their brethren offered in panic. The year 1711 was one of expanding foreign trade, a fact which helped to direct attention to the stocks of trading companies, more particularly to those of the United East India Company, which had now enjoyed for two years the benefits of a blending of former rivalries and which also had experienced in its new form the privilege of coming to the financial aid of the Government. A large number of insurance companies were formed in the reign of Queen Anne; most of them were freakish and ephemeral, concerning themselves with the risks of marriage and the like. But one, the Sun Fire, was destined to become famous and soon reached the dividend stage. The Sun Fire had the advantage of being administered by a committee of seven; the majority of companies at this time had a cumbrous administrative, twenty-four directors being the rule, with a Governor, Deputy-Governor, and even a Sub-Governor.

Preference Capital: A Stockbroker's List

No marked evolution in the forms of capital occurred within this period. We may note, however, that towards

the end of Anne's reign there was formed a company for the making and vending of oil extracted from beech nuts. The company seems to have been formed principally for lining the pockets of its ingenious promoter, but the holders of a certain class of stock were entitled to a fixed dividend to be paid before any distribution was made on the Ordinary Stock. We are thus provided with our first instance of Preference Capital in English investment history. A writer of some years before, when satirizing the times, uses the word debentures, but we cannot be certain he is not using the word merely as an alternative to stock, since no evidence has survived of a company at that time having issued debentures as we now understand them. Some hints are observable from 1712 onwards of a tendency to distinguish between stock and shares, in the sense of the former word being reserved more particularly for the securities of the Chartered Companies or Government Loans, the word Funds also being used for the latter. We shall, however, continue in this narrative to use the word stock to designate all classes of capital until we arrive at the time when the difference between stocks and shares is more precisely determined.

The word share is not used in the first list of prices to be published by an actual stockbroker, namely, in that of John Freke, which appeared regularly during a number of years from about 1715. His list also contained, by the way, a few quotations of foreign exchange rates and notices relating to the Bank of England.

The Sinking Fund

Anne's reign terminated amid misgivings as to the good order of the nation's finances, which is understandable in view of the official admission that large sums had been used by the Exchequer no one quite knew how. Critics of the Government alleged that £36 millions had thus

disappeared. It may be only a coincidence that the National Debt during the last dozen years had increased by approximately this figure and now stood at over £53 millions. In spite of criticisms and admissions, the Government of this time was able to borrow at 5 per cent and two years later floated a Loan at 4 per cent, although the success of the latter was held in suspense by the City, which subscribed reluctantly, declaring that the rate of interest offered was absurdly low. But the feat was accomplished; the success may have been partly attributable to the fact that the Government conceded the claims of tractarians that interest paid on the National Debt should be wholly free from any Government impost. Taxes specifically allocated to meet interest on these two loans yielded a surplus over the amount required; these excesses accrued to the credit of the Government. The surpluses were to serve two years later as the basis of a scheme for the progressive redemption of the National Debt; for in 1717, the year in which the Bank of England began the payment of dividends on behalf of the Government, Sir Robert Walpole established with an initial amount of £323,000 what afterwards became known as the Sinking Fund. Somewhat earlier many of the taxes on which loans were charged had been consolidated and the taxes, hitherto deemed to be tentative and subject to revision, were thereafter termed perpetual. It would follow, subject to considerations mentioned later, that if the yield from the perpetual taxes were maintained or increased and the Government Debt remained stationary, whenever the Government was able to reduce the average interest on that Debt, so there would be a surplus of taxes to be devoted to redemption purposes. We have to assume, in order to make the foregoing tenable, that successive Governments would not use the proceeds of perpetual taxes in ways otherwise than originally pledged, or to

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divert from the Sinking Fund any surplus those taxes afforded. A still greater assumption needed is that Governments would refrain from borrowing on the Sinking Fund itself and so increase the Debt at as rapid a rate on the one hand as they reduced it on the other. Assumptions such as these ask too much of human nature for them to hold good over a lengthy period, but during the first twenty-two years of Sinking Fund operation the National Debt was reduced by £8 millions.

A feature of financial activity in the two years after the inauguration of the Sinking Fund was the formation of insurance companies of a much more responsible type than any of those launched previously, with the exception of the Sun Fire Office, special attention being given to marine insurance. New companies included the Royal Exchange Assurance and the London Assurance.

The Ideas of William Law

In 1719 occurred a slackening of trade and the beginning of immense speculation in Paris. France then enjoyed the society of William Law, a Scotsman who had vainly endeavoured to persuade his fellow-countrymen to issue bank notes to the estimated value of the land of Scotland. The unsoundness of Law's proposal is not difficult to detect. Who can say what the total value of a nation's land will be in a few years' time? Or who is to say the degree of reality in the value placed upon a nation's land at any time, let alone in that placed by assessors preparing the way for inflation? However, Law found sympathetic ears in France, where he was rewarded with high office, and under the auspices of himself and his patrons that country was flooded with paper money. Law's currency ideas were mingled with others equally ambitious, including schemes for conversion of the National Debt of France and the virtual consolidation of the whole French nation into a banking

and industrial trust with French foreign trade a monopoly of the French Indian Company, prices of the shares of which were prodigiously manipulated on the prospect.

The Great Gamble

Although Law's currency notions were discredited on his native heath, London could not escape the fever of the fictitious rise in prices of commodities and securities which he had engendered, and neither could influential Englishmen escape altogether contagion of his expansive idea. Therefore, not to be behind in doing things on a grand scale, the directors of the South Sea Company offered to take over £40 millions of the English National Debt in return for an interest of 5 per cent until 1727 and of 4 per cent after that date, the Company to pay £3½ millions in return for the privilege. The Bank of England, alarmed at the power that would thus pass to the South Sea Company, outbid the Company, which outbid the Bank in turn. Finally, fortunately for the Bank, the South Sea Company won the day, having agreed to pay the Exchequer double what it offered in the first place. Forty millions of Government stock passed into the possession of the South Sea Company, the original holders of the £40 millions receiving South Sea Stock in exchange. The Company, when it took over £9 millions of Government Debt in 1711, acquired borrowing powers far in excess of what could be used for genuine trading purposes, but apparently the directors refrained from exercising other than a moderate portion of their credit facilities. At any rate, we have no evidence that the credit facilities were abused. Such was not the case in 1720; for then the directors of the South Sea Company with enormously increased borrowing powers used them for gambling in the Company's own stock and committed other financial misdemeanours, including making loans to certain shareholders on the basis of

unwarrantable valuations of South Sea Stock. As we have seen, the time was ripe for gambling mania. All kinds of optimistic rumours spread like wildfire, some of which most probably emanated from the directors and from the members of the Government, who were subsequently discovered to have profited from the rigging of the market for the stock. The price of South Sea stock rose in six months from £126 to £1,000, and prices of stocks of all other companies rose preposterously. New joint stock companies were floated at an amazing rate; in one week invitations were issued to subscribe to companies with a nominal capital of £200 millions. An indication of the frenzy of dealings is to be found in the fact that 36,000 transactions in South Sea Stock were recorded in one week. The Government was now alarmed and issued a proclamation designed to check the formation of new companies; the proclamation had little effect. Next, the directors of the South Sea Company themselves became seriously perturbed and secured the issue of writs against over eighty companies on the ground of so-called illegal incorporation. In September, 1720, prices began to fall as rapidly as they had risen; where rumours were lately invariably optimistic they were now uniformly of an opposite kind, and the hitherto disparaged sceptics of the boom began to be treated with respect. Soon ruin was widespread, companies vanished over-night, the Bank of England was severely shaken but ingeniously withstood the strain; Cabinet Ministers were indicted, disgraced, and their estates impounded.

The Bubble Act

The outcome of the South Sea extravaganza, in so far as it bears upon our theme, was that joint stock companies were placed under a heavy cloud, while the profession of stockbroking, none too kindly regarded before the boom,

became in public opinion synonymous with knavery and the subject of much antagonistic legislation. The Bubble Act, as it was termed, made the formation of joint stock companies a difficult and costly matter, and after its passing a joint stock company could not be formed without the obtaining of a Charter from the Government. That this legislation was beside the mark is evident when we grant that stockbrokers played little part in beginning the scandal, although they may have gladly shared in the spoil. The rate of increase of non-chartered companies was a menace, but the mere subsidence of the boom would probably have proved sufficient check, and, after all, a Chartered Company was at the bottom of the mischief. However, as a consequence of the legislation, over the next three-quarters of a century we have before us the unstimulating spectacle of an embryonic Stock Exchange in a legal strait jacket, while, as far as companies are concerned, our inquiry over this period can but deal with those unchartered companies which survived the catastrophe, the Chartered Companies then in existence, and Chartered Companies formed subsequently.

1722 AND A BANK OF ENGLAND RESERVE

The Government forgave the South Sea Company the £7 millions it had promised for the Treasury coffers and a readjustment of the Company's capital was skilfully made; the holder of long-term Government Debt who had received South Sea stock suffered least; the holder of short-term Government Debt, similarly blest, suffered most. As a result of this readjustment and the subscription of new money, the capital of the South Sea Company at the end of 1722 was £32 millions. In this year, the directors of the Bank of England, moralizing over recent happenings, began a Reserve Fund which till then had been regarded as unnecessary, if it had been thought about at all.

CHAPTER VII

FROM GEORGE II TO THE END OF THE NAPOLEONIC WAR

1727 to 1739—The British Linen Company—A "run" on the Bank—Pelham's Conversion Scheme—Government borrowing apace—Lottery loans—Mr. Mortimer's book—Sixpence at the bar—The move from Jonathan's—The title over the door—The Bank of Ireland formed—The East India Company's lessened powers—Foreign investments in British Funds—The Age of Invention—1786 and a new Sinking Fund—Twenty years of war—Suspension of cash payments by the Bank of England—Growth of foreign investments—The activities of Baring Brothers

THE first twelve years of George II's reign, that is, from 1727 to 1739, were years of peace, and therefore the necessity of the State to borrow was small. This might not have deterred the Government from adding to national obligations, save that Sir Robert Walpole was in power during the whole of the period and prudent finance a strong principle with him. Companies which had survived the crisis of 1720 proceeded on even keel; the East India, Hudson's Bay, and similar concerns benefited from the steady expansion of England's foreign trade, the Sun Fire, Royal Exchange, and London Assurance expanded as the advantages of sensible provision against contingencies gained wider recognition, and the growing utility of water supply undertakings strengthened the prosperity of this class of joint stock venture. Home industry developed, but not markedly, the finance being provided by an individual or by means of partnerships. In George II's thirty-three years as monarch, only one important joint stock company was formed, namely, the British Linen Company, which came into existence in 1746. Originally formed to foster the linen industry, this Scottish association subsequently turned to banking under the title of the British Linen Bank.

A Run on the Bank

Sir Robert Walpole's peace policy at length succumbed before popular clamour demanding war with Spain. The Spanish War brought hostilities with France also, but these might have come otherwise, in view of the clashing of French and British colonists and of French and British trading companies in the New World and in India. The Spanish and French Wars undid the benefits of Sir Robert's frugality, and whereas at the end of 1739 the total National Debt amounted to £47 millions, seven years later it had risen to £72 millions. Meanwhile, in 1742, the Bank of England Charter was renewed and the Government used the opportunity thus afforded to obtain a Loan of £1,600,000 from the Bank, the Loan not to bear interest. The granting of this Loan necessitated raising the Bank's capital to £9,800,000. Three years afterwards the Bank experienced a "run"; the occasion being Prince Charlie's Jacobite rally, soon to be ruthlessly suppressed by the Duke of Cumberland. The Bank withstood the "run" cleverly, if not with ease; the incident is most noteworthy, from the fact that London merchants met together and pledged themselves to accept the Bank's notes and to refrain from demanding gold. It is evident that the Bank was now regarded by the City as a national institution to be safeguarded by common resolution in times of emergency.

We may note in passing that in 1749 the contention was advanced that it was impossible to tax the interest of money, since the rate of interest would merely rise in proportion to the tax. A more defensible economic doctrine put forward somewhat later was that merchants "ought to be allowed to accumulate riches as fast as they can, because they employ them for the advancement of industry; and every deduction from their profits is a diminution upon that so useful fund."

Pelham's Conversion Scheme

The rapid augmenting of the National Debt meant an appreciable addition to the yearly amount which the nation had to find for interest, and in 1750 Henry Pelham, the then Chancellor of the Exchequer, essayed the task of easing the burden. He did so by offering holders of a number of Government Loans which he had power to redeem, either repayment in cash or new stock. The average rate of interest on the old stocks was 4 per cent; interest on the new was to be 3½ per cent until 1757, and from that date onwards only 3 per cent was to be paid. This first Government Loan Conversion Scheme proved highly successful, people readily changing their old Stocks for new. The new 3 per cent Consolidated Stock created was retained in British Government finance until the rearrangement carried out by Mr. Goschen in 1888. A year before the interest on Conversion Loan fell to 3 per cent, England was again at war and we read of the Government issuing a New Loan at 3½ per cent, and in 1760 another at 4 per cent. Naturally the issue of these Loans at higher rates of interest caused a decline in the price of the 3 per cent Loan.

Government Borrowing Apace

Government borrowing now proceeded apace and when the war ended £75 millions had been added to the National Debt, the total Funded and Unfunded Debt of Great Britain amounting at the beginning of 1764 to over £139 millions. The composition of this Debt calls for no special comment, but it should perhaps be said that raising money by State Lotteries, practised hesitantly since the days of William of Orange, became accepted in George II's days as a quite legitimate method of obtaining money for national purposes, nearly £3 millions being so derived from 1758 to 1765. Payment by the State of lottery prizes

does not result in an addition to the National Debt, excepting when the prizes or "premiums" exceed receipts from the sale of tickets, which in England has been but rarely, if at all. Therefore, although some eighteenth century statisticians include in the National Debt an unspecified allowance for a Lottery Fund we can regard the amount as negligible. Nevertheless, as lotteries were for long a part of government finance we cannot exclude all reference to them, more especially as State Lottery Tickets were bought and sold by stockbrokers, prices of some of the tickets reaching twenty to thirty times the original face subscription value. Whether or no gambling in State Lottery Tickets is to be considered an advance on speculating in joint stock companies is a fine point; but there was no relaxation of restrictions on the latter activity.

Mr. Mortimer's Book

It would be remiss not to record that about this time, in 1761 to be precise, the first guide to the purchase of stocks appeared under the title of *Every Man His Own Broker*. The Mr. Mortimer who wrote the book is as much concerned with putting the public on its guard against brokers as he is with anything else. He warns his readers that it is the broker's business to throw out all possible baits to engage people to be continually changing from one fund to another, "every movement of this kind producing fresh commission money." It is evident from his description that all the Government regulations for the control of the buying and selling of stocks had singularly little effect; for he tells us that "Every person who enters Jonathan's to do any business there, pays 6d. at the bar, for which he is entitled to firing, ink, pen and paper, and a small cup of chocolate; and if he understands the business, is as good a Broker for that day (at least for his own affairs) as the best." This reveals that some investors

and speculators were in the habit of making their sales and purchases without the aid of an intermediary, which is understandable, as the vast majority of transactions were in the Government Funds, Bank of England, East India, and South Sea Stocks, where the documentary procedure of transfer was well-established and straightforward. Mr. Mortimer has not much to say upon investing as a fine art; but he does make the observation that the value of Government Stock is dependent not alone upon the credit of the Government but also upon the current rate at which money can be borrowed, emphasizing the point to excess.

The Move from Jonathan's

Whatever may have been the character of brokers generally at the time Mr. Mortimer wrote, the enormous increase of Government Loans was giving them increasing importance in the affairs of the nation, and in 1764 we find the brokers who dealt in the Funds deserting Jonathan's that they might gather in the Rotunda of the Bank of England, a position of convenience as well as of respectability, since the transfer of Government Stocks and the payment of Government dividends were made through the Bank. In that year the Bank of England Charter was again renewed, and again the renewal was granted for a consideration. On this occasion the Bank gave £110,000 to the Government and lent it £1,000,000 for two years at an interest of 3 per cent. It should be mentioned that the Bank had since 1759 issued notes for £15 and £10, so entering into the financial life of a wider circle; note issues before that date were of higher denomination. Nine years later the brokers remaining at Jonathan's passed a resolution that the title should be discarded in favour of the Stock Exchange, which was to be written over the door. A committee of management was formed

and a few rules and regulations framed for the conduct of business.

In 1802 a new Stock Exchange was opened in Capel Court, having been built by the aid of £20,000 in £50 shares subscribed for the purpose.

Adam Smith on Joint Stock Companies

It must be mentioned that in 1776 was published Adam Smith's masterpiece, *The Wealth of Nations*. Adam Smith expressed the opinion that the only trades which it seemed possible for a joint stock company to carry on successfully without an exclusive privilege, that is to say a monopoly, were banking, insurance, canals and water supply companies. "First, it ought to appear with the clearest evidence, that the undertaking is of greater and more general utility than the greater part of the common trades; and, secondly, that it requires a greater capital than can easily be collected with a private co-partnery. The joint stock companies which are established for the public-spirited purpose of promoting some particular manufacture, over and above managing their own affairs, to the diminution of the general stock of the society, can in other respects scarce ever fail to do more harm than good." Adam Smith appears to have been influenced by the number of joint stock companies which had failed during the past 150 years, quoting a French authority who mentioned fifty-five joint stock companies engaged in foreign trade which, although they had exclusive privileges, nevertheless failed. The number of failures does not appear formidable to us at this date, particularly having regard to the length of the period which they covered. The truth is that Adam Smith had insufficient data from which to discern the limitations and the possibilities of the application of the joint stock principles. On the other hand, he rightly said that if the interest of money was

taxed, the capital might be transferred abroad, remarking that the proprietor of stock is properly a citizen of the world and is not necessarily attached to any particular country. This last may not be flattering to patriotism, but history provides plenty of examples of capital being transferred abroad because of high taxation or from other self-protective reasons.

The East India Company's Lessened Powers

The last twenty years of the eighteenth century yield us little in company history. We have in 1781 the familiar spectacle of the Bank of England renewing its Charter. It again lent the Government £2,000,000 at 3 per cent, but this time made no gift, the contention being put forward that as Government 3 per cent Stock could be bought in the market at £58, or £42 below its par value, the Bank was behaving handsomely in lending to the Government at 3 per cent. The argument is reasonable, but we may recognize also in the terms of renewal a decline in the power of the Government to exploit the Bank's resources. The granting of the Loan caused the capital of the Bank to be increased to £11,642,000. Two years later the Bank of Ireland was formed with an initial capital of £600,000 in 4 per cent Stock, at much the same time as the affairs of the East India Company came to a crisis, control of civil or military government and also of revenue of the territories in which the Company operated being taken from it and given to the British Cabinet. The Company, however, still retained a monopoly of the British trade with India and China, but in 1793 the Company's monopoly, as far as India was concerned, was limited to certain imports and exports, independent traders being compelled to employ the Company's ships. Incidentally, it was in this year that the first issue of £5 Bank of England Notes was made. The limitation of the

powers of the East India Company had among other effects that of lessening the prestige of Chartered Companies and so helped to make the way clear for the emergence of the ordinary joint stock company, which had been held back for over seventy years by Government hindrance.

Foreign Investments in British Funds

It is surprising to learn, since England's relations with other Powers were frequently strained, that foreign investments in British Funds, somewhat before 1780, amounted to one-seventh of the total. We must remember, however, that the Dutch were the great financiers of those days and that for seventy years their contact with England had been close, although it was soon to be broken by disastrous conflict. These foreign investments in English securities were the expression of an international tendency in finance which over the next half century was to deepen and widen beyond all recognition. Additionally, although the amount of Debt represented by one-seventh is substantial, it was probably in relatively few hands, since the total number of holders of British Funds at this time was round about 17,000.

The Age of Invention

Another movement was also gathering force and one which was to have a profound influence on the distribution of capital and the forms of capital employment. The Age of Invention had arrived. "The great changes in man's command over Nature and consequent manner of life," says Mr. G. M. Trevelyan, "which began in England in the reign of George III, and have since spread with varying degrees of intensity over almost the whole inhabitable globe, make bewildering work for the historian. Up to the Industrial Revolution, economic and social change, though continuous, has the pace of a slowly moving stream,

but in the days of Watt and Stephenson it has acquired the momentum of water over a mill-dam, distracting to the eye of the spectator. Nor, for all its hurry, does it ever reach any pool at the bottom and resume its former leisurely advance. It is a cataract still." The early inventions of George II's reign affected mainly the iron and textile industries and were financed by wealthy manufacturers, while widening of roads between 1760 and 1773 and in certain instances of canals was undertaken by the Government. But it was plain that the demand for finance caused by the Industrial Revolution was being very inadequately met by private and State capital. Whatever changes might have been imminent were retarded by the War of American Independence in 1775, which before it ended brought France, Spain, and Holland also into conflict with Britain and added £97 millions to the National Debt.

1786 and a New Sinking Fund

The rapid growth of the National Debt aroused alarm and many schemes were put forward which, it was claimed, would bring about automatic reduction, the eventual selection from these schemes being the creation in 1786 of a New Sinking Fund. According to this scheme, introduced by Pitt, the Sinking Fund was to be built up partly out of revenue surpluses and partly by the aid of a proportion of the capital raised by new loans. The Fund thus created was to be used to buy up portions of the National Debt. The mighty benefits which were expected from the Sinking Fund failed to accrue, partly because of a generally fallacious notion of the power to redeem debt by this means and more because the Government was all the time borrowing fresh money on a scale which placed the National Debt beyond all hope of redemption. After many modifications the Pitt Sinking Fund was abandoned in 1829, and in its place was adopted the mild recommendation

of a Select Committee to apply "a surplus revenue perseveringly" to the reduction of the National Debt, so leaving much to the imagination of what constituted a surplus revenue, a liberty of which subsequent avid Chancellors were not slow to avail themselves. What the Pitt Sinking Fund accomplished has been succinctly stated in a Government paper. "The actual result of all these Sinking Fund operations," says this document, "was that the total amount of £330,050,000 was raised at £5 0s. 6d. per cent per annum to pay off debt carrying interest at 4½ per cent per annum. The difference between these two rates . . . . may be set down as the increased annual charge of our Funded Debt, and a real loss to the public from this deceptive Sinking Fund System, without taking into account the expenses of management of the Sinking Fund, and the increased amount of capital of debt consequent upon the practice of borrowing on less advantageous terms far larger sums than were required to meet the actual public expenditure." The Report on the National Debt issued in 1891 gives the total payments under the Pitt Sinking Fund as £325,959,000, or somewhat under the figure mentioned in the earlier document from which we have quoted.

Twenty Years of War: The Bank Suspends Cash Payments

In 1793 began yet another chapter of the sickening story of eighteenth-century wars; on this occasion the conflict was to last a score of years. As an outcome of these wars of the French Revolution and Napoleon, Britain's National Debt, which stood at £247 millions at the beginning of 1793, amounted in 1815 to £861 millions, or about £43 per head of population. The revenue required to meet interest on the Debt was £29 millions and Government administrative expenses £49½ millions, making a

total of £78½ millions to be supplied each year by the British people. In spite of the war and in spite of the activities of machine wreckers, the building of factories, buying of newly-invented equipment, and the making of canals continued steadily. The withdrawing of money for these purposes is said to have played a part in causing monetary stringency, but the suspension of cash payments by the Bank of England in 1797 was directly attributable to the war, and full resumption of cash payments did not take place until four years after the end of the second war, that is, in 1819.

The Income Tax Arrives

We must not leave this period without recording the fact that in 1799 the Income Tax was first imposed, the rate being 2s. in the £. Pitt estimated that the tax would produce £7½ millions for the year; actually £6 millions was obtained, which cannot be considered a disappointing result, inasmuch as the field had not been previously explored. The Income Tax was destined to become as much a part of the Englishman's life as bacon for his breakfast, and eventually every dividend he received was to be accompanied by the pleasing intimation that directly or indirectly the Government had had first picking under Income Tax Law. Englishmen at the beginning of the nineteenth century were fully alive to the dire potentialities of the Income Tax, and twice they succeeded in getting the tax repealed, the occasions being 1802 and 1816. But subsequently the Income Tax received from the fiscal gods the gift of what looked suspiciously like immortality, being reimposed in 1842 and levied annually from that date.

Growth of Foreign Investments: The Activities of Baring Brothers

The fact that England was on a paper standard would not in the ordinary course have stimulated the flow of

investment, but the possible influence of that condition was modified by the circumstances of the finances of other nations being precarious. Consequently, there were already signs of that growth of foreign investment which was to be so marked a feature from 1822 onwards. Indeed, the very result of the Napoleonic War provided a great impetus to the international distribution of debt. France agreed to pay an indemnity of 700 million francs, and she was helped to do so by the flotation of Loans, several of which were undertaken by the London firm of Baring Brothers, whose management was in the hands of Sir Alexander Baring, a Director of the Bank of England and also a Member of Parliament. The greater part of these Loans were taken by British subscribers, but subscriptions were also forthcoming from capitalists in Austria, Germany, Russia, and in France herself. The familiarity with foreign investments induced by these Reparations Loans led to British purchases of Loans subsequently floated in France by the French Government. Then, too, in 1818 Rothschilds issued in London a Loan for £5 millions on behalf of Prussia. It was the same firm which six years later heralded the revival of joint stock companies by floating the Alliance Insurance Company.

CHAPTER VIII

FROM 1820 TO THE BANK ACT OF 1844

FROM 1820 onwards—Stocks and shares—The altered attitude of the State—Banking changes—The 1844 Act—South American borrowers—Financing liberty—What was lost—Canal dividends—1834–1836—Railway companies—The United States as borrower—Securities in 1843—Broker and jobber—The Bank Rate

Now that we have arrived at the lively days of stolid George IV, a strictly chronological record with no leapings forward or backward will hardly serve to illumine our way. We have come to a period of history where industry, banking, and finance generally develop at brisk although uneven pace, where the influences bearing upon investment are diverse and fluid and yet have within them elements of permanence. Therefore, we must take broader views than hitherto demanded of us, and, so far as is practicable, look upon incidents more as evidence of a phase, actual or foreshadowed, than of slight changes from one year to another.

The span of approximately a quarter of a century from 1820 onwards is the span of our present chapter. It is a period when English textile, coal and iron industries grew rapidly, when the rising industrialists, absorbed in the use of new powers, were far from solicitous of the welfare of those who tended their machines. Agitation on the part of the working classes was widespread. Nevertheless, progress was distinctly in the air; railways were built and the first Transatlantic steamship voyages made. Penny Postage was introduced throughout Britain. Tariffs had been reduced or eliminated; complete Free Trade had yet to come, largely because the needs of British agriculture were thought to demand a tax on imported corn. An alternative to tariffs as a means of raising revenue was

a restoration of the Income Tax. Sir Robert Peel when allowing in his 1842 Budget for an Income Tax of sevenpence in the £ was animated by a belief that the reduction of duties on raw materials and semi-manufactured articles, which the re-imposition of Income Tax helped to make possible, would prove beneficial to British industry. The population in these twenty-five years grew from 12 millions to just under 16 millions; the real value of the annual exports of British produce and manufactures increased from £36½ millions to £51½ millions; the annual charge on the National Debt declined by rather less than £2 millions a year.

Stocks and Shares

The background depicted, we had better next ask ourselves whether or no it is necessary to add to our knowledge of terminologies employed, or, at any rate, to perceive more subtle distinctions in the meanings of certain words. Only one change in this direction need be borne in mind at the outset; which is, that we should recognize at this stage of our inquiries a line of division between stocks and shares. The word stock had definitely come to be associated with issues bearing a fixed rate of interest, especially those on behalf of Governments and where the denomination was £100 nominal or clearly recognizable as related to that base. Use of the word stock was to be furthered with the formation of railway companies, the designation figuring much in the capital arrangements of those concerns. It must be said that stock in the modern sense need not necessarily be of fixed interest character, and it can be of as low a denomination as £1. But all that we are immediately concerned with are the general conceptions of stock and share in 1820, and thereabouts. Something of plainness having been acquired on this point, the main thread of our narrative may be resumed.

The State Changes Its Attitude to Companies

An outstanding feature of our journey to the present has been the tendency of the State to rely upon companies for financial aid from time to time; but we have also noticed a modifying of this tendency, until at length the Bank of England alone has been called upon to smooth a little the rough path of Chancellors of the Exchequer. The admission of the State's financial domain as a separate entity, not to be dependent upon private institutions for gifts, exactions, or forced loans, is clear cut at our starting post of 1820. Not only so; we find the State abandoning its century-old attitude of impeding the formation of any type of company which could be independent of a close relationship with the State itself: and, more noteworthy still, loosing the ties of those Chartered Companies in whose affiliation it had previously taken jealous pride, and depriving in 1834 the East India Company of its last monopoly, namely, of trade with China. The year 1825 witnessed the removal of many statutory hindrances to joint stock association, but members remained personally liable for the whole or for any part of the debts of the corporation in which they had an interest. This stipulation was to be enforced for another thirty years. In 1844, however, the facilitating of joint stock enterprise was carried further by making less onerous the legal requirements of company formation.

Banking Changes

Simultaneous with the separation of the State from joint stock enterprise was the introduction of banking changes, most of which can be regarded as reforms, although in one direction the new policy had results manifestly undesirable. By this time the goldsmith-bankers were no more; their dual identity had disappeared and they had become simply bankers, specializing in lending

money on commercial securities. The Bank of England, we may recall, was protected from the competition of note issuing joint stock banks by a law which declared that no banking concern with more than six partners could issue bank notes in England, and, as banking was commonly but erroneously considered an unattractive pursuit without this right, no development of joint stock banking occurred. Thus, the way was left open to all sorts and conditions of people to term themselves banks and issue notes, while the right was denied to combinations with far greater resources at their disposal. Consequently, in the provinces many tradesmen issued notes which were accepted as long as the good names of the tradesmen were unquestioned and as long also as no national crisis awakened widespread uneasiness. In 1823 the Bank of England increased its note issue; this was followed by an increase in the notes of country bankers. A sharp rise in commodity prices ensued, which may not have been wholly regrettable; but upon this rise, conditions of financial strain supervened and failures of small country bankers were numerous. Exposure of the weakness of the existing banking system led to the passing of an Act in 1826, whereby joint stock companies were permitted to carry on the business of banking with power to issue notes, but it was stipulated that joint stock banks were not to operate within 65 miles of London, a provision intended to preserve the monopoly of the Bank of England. Seven years passed, and the prohibition of joint stock banking in London was removed; the London and Westminster Bank came into existence in 1834, to be followed two years later by the London Joint Stock Bank. By the end of 1836 there were ninety-one English joint stock banks, of which seventy-nine issued notes, the total note circulation of these seventy-nine then amounting to £4½ millions. The conceding to joint stock concerns of the right to carry

on banking anywhere in England was of great value to industry and commerce, but the weakness of allowing unlimited note issues by private banks had been left untouched, while the granting of similar power to joint stock banks accentuated the lack of coherence in the nation's currency policy. The gravity of the omission was demonstrated unmistakably over the next few years, and in 1844 it was enacted that no private or joint stock bank to be formed after that date should have the right of note issue, and the powers of note issue retained by the 172 joint stock banks and 227 private banks then in existence were curtailed.

South American Borrowers

Improvement and extension of a banking system are great aids to the movement of capital. Enthusiasm for the cause of liberty is said also to have played a part in directing the trend of investment during the opening of George IV's reign. South America had shaken off the yoke of Spain, and, naturally, the new-born Republics came to Spain's old enemy in order to finance their aspirations. They did not come in vain, although they paid rather highly in commissions so that there might be no doubt of the cordiality of their reception. However, as, with the exception of Brazil, all of the South American States were soon to default, that intermediary expenses were high is a relatively unimportant matter. The British investor had early warnings of the peril he ran in parting with his cash to countries of fledgling constitution and primitive economic organization; for in 1820 Colombia, one of the earliest of South American borrowers in England, fell behind with interest payments very shortly after she had contracted a loan. But so credulous were the times that two years later Colombia floated another loan in London; we must gratefully acknowledge the atoning factor that

Colombian securities with interest arrears were accepted as subscriptions to the new and larger loan. Greece was another portion of the globe where the struggle for liberty required to be financed, and on her behalf 5 per cent Stock was issued in London. The issue price of each £100 nominal of this last stock was 56½, so that Greece was really being called upon to pay nearly 9 per cent interest. All of the loans issued at this time for the benefit of foreign governments were issued at discounts. It can scarcely be supposed that this procedure concealed from borrowers the rates of interest which were actually being charged; the apparent cheapness of stock sold at discounts attracted the inexperienced British public, and this may have been the sole design. Naples commanded the highest credit in those days; her 5 per cent stock was issued at 91½, while Mexico was ranked in advance of Denmark. It may be remarked that the connection of Barings with Argentine and of Rothschilds with Brazil dates from this period. Enthusiasm for the cause of liberty may also have directed the flow of British money into South American mining ventures, but, on the other hand, so may also the reports of fabulous richness of ore deposits. The shares of the Anglo-Mexican and the United Mexican swiftly rose to over fifteen times the amount paid upon them by original shareholders, and those of the Real del Monte to eighteen times. It is evident that here were seeds of disaster; especially as in 1824 and 1825 prospectuses appeared inviting subscriptions to a miscellany of other enterprises, many of an extremely speculative kind.

What Was Lost

The losses suffered by British investors in the eighteen-twenties through the almost complete collapse of South America and the failure of Governments and companies generally have been placed by some investigators at very

high figures, £150 millions and more being mentioned. It is probable that the losses were substantially less than £150 millions. *The Times* at the end of 1824 gave Britain's total foreign investments as just under £48 millions, not all of which were impaired by subsequent events. If we accept another current estimate that £174 millions had been invested in home and Colonial enterprises, it would be sweeping to allege that two-thirds or so of this total of £222 millions were irretrievably lost. It was at this time that were formed such long-lived concerns as the Australian Agricultural Company, the Canada Company, the Imperial Continental Gas Association, the Catherine Dock Company, the West India Dock Company, the General Steam Navigation, and the Thames Tunnel. The Stockton and Darlington Railway was opened in 1825 and numerous other railways were at an early stage of planning. We have also the fact that many canals which had been privately financed from 1790 onwards and had latterly passed into the control of joint stock companies were earning substantial profits. According to a writer in an 1825 issue of the *Quarterly Review*, eighty canals with a total capital of £13,205,000 returned an average of 5¾ per cent dividends. The total number of joint stock companies in existence was 276, of which 48 were railway companies.

1834–1836: Heavy Capital Subscriptions

Although the disasters to British investors in the years between 1820 and 1830 in all probability were not as great as is often said, there can be no doubt they were of considerable magnitude. This being so, it is an indication of the rising strength of the impulse to invest that from 1830 onwards employment of money in stocks and shares developed at a remarkable rate. In the three years from 1834–1836 inclusive the nominal capital of new joint stock

companies amounted to over £105 millions, of which the greater amount was for railway companies, this being the time of the formation of the London and Brighton, South Eastern, South Western, and other important railway concerns. The United States took the place of South America as a welcome foreign borrower, the various States making the principal demands upon the British investor. Money was also supplied for American canal and bank companies. Unfortunately, the economic organization of these States was elementary, and with some of the States ideas of financial honesty were crude. Repudiations of obligations were soon forthcoming and, as at much the same time, serious banking failures occurred in the United States, once more a substantial amount of British savings disappeared into thin air.

Securities in 1843

The amount of British investments in the United States round about 1840 has been estimated at figures varying from £22 millions to £40 millions. All that we can do is to take a figure midway. Few statistical compilations with regard to investments can at this stage of our investigation be regarded as exact; as an illustration of the broad stream of tendencies they serve a useful purpose, even although we view them with a certain reserve. This is true of the table on page 80 of the nominal value of securities quoted upon the Stock Exchange in 1843.

Some Reflections on the Figures

There is no apparent cause to question the figures of the British and Irish Funded Debt or of the Loans to Foreign Governments, including the United States, but the total figure for joint stock companies presents difficulties. We have learnt it was estimated in 1824, that is, nearly twenty years previously, that £174 millions had been invested in

Home and Colonial enterprises; a total of £224 millions for 1843 allows for an addition of less than £3 millions per annum in the interim. Admittedly, it has to be borne in mind that a number of companies which were alive at the first date had ceased to exist by the second, and so make no contribution to the capital account of 1843. On the whole, however, the figure of £224 millions looks below

	£
British and Irish Funded Debt	773,000,000
Loans to Foreign Governments (including the United States)	121,500,000
Total Government Stocks	£894,500,000
70 Railway Companies	57,448,000
Banking and Interest Companies	46,450,000
59 Canal Companies	17,862,000
8 Dock Companies	12,177,000
Turnpike Trusts	8,775,000
East India Company	6,000,000
South Sea Company	3,663,000
24 Foreign Mining Companies	6,465,000
81 British Mining Companies	4,500,000
107 Assurance Companies	26,000,000
27 Gas, Light and Coke Companies	4,327,000
11 Water Companies	2,536,000
5 Bridge Companies	2,124,000
4 Literary Institutions	1,003,000
196 Shipping, Land, Asphalt, Loan, etc. Companies	25,000,000
	£224,330,000

the mark, at least as far as investments in railway companies are concerned. The table is specially useful as indicating the variety of investments at this date compared with those at the beginning of the century, although investments are still only in the childhood of diversity, for it will be noticed that the amount invested in joint stock home industrial enterprises is small, much the greater amount of capital subscribed being for the development of railways, canals, docks, roads, banking, and assurance. That capital flowed mainly in these directions was sound; for the provision of adequate transport and finance is

an essential preliminary to industrial development which is to be lasting. The favourite investment at this time was railway stock; two years later the stocks of railway companies were caught up in a wild bout of speculation, wherein little distinction was made between companies working or which hoped to work, between companies formed to operate in Great Britain and those which were to contend with great engineering difficulties beyond the seas. British railway contractors, by reason of the fame of Thomas Brassey, had already acquired a universal reputation, and orders had been received from France for nearly 400 miles of railway construction. The material required for railway construction work at home and abroad gave an immense impetus to British industry.

Broker and Jobber

The larger number of securities dealt in naturally caused an increase of Stock Exchange membership. How long it had been so does not emerge from the sources of information available, but by 1844 the broker and jobber were no longer one and the same person. Their separate functions were clearly recognized. The broker was the person who bought or sold securities for the public, doing so through the jobber. The jobber bought from or sold to the broker; his remuneration was called a "turn," being the difference between the price at which he would buy and the price at which he would sell a security. In other words, the jobber was the middleman between broker and broker, making the market.

The Bank Rate

We must observe before taking our way over another quarter of a century that with the passing of the Bank Act of 1844 the minimum rate of interest charged by the Bank of England for discounting first-class Bills became the

touchstone of monetary rates, and that from this time relating the value of fixed interest securities to the prevalent Bank Rate, as it was henceforth to be called, passed into a habit of investment practice. Before this time the Bank Rate, then usually known as the Discount Rate, had performed the same function, but, as Bank Rate, after the banking reforms of 1844 it acquired additional authority and was more widely taken into reckoning. Indeed, the limitations of Discount Rate practice, as previously conceived, can be seen from the fact that between 1704 and 1837 the range of variation was only from 4 per cent to 5 per cent and from 5 per cent to 4 per cent.

The average Bank Rate for 1844 was £2 10s. per cent and for 1845 it was £2 13s. 8d. per cent, the highest price of 3 per cent Consols in the two years being just over 100 and the lowest rather more than 70. It will be seen that the broad tendency was for Consols to yield on their market price ½ per cent more than the figure of the Bank Rate. In 1820, where we began this chapter, the highest price of Consols was 71½ and the lowest 65⅝. But meantime the Funded Debt had been reduced by approximately £100 millions. Measured by the price of National Stock, Government credit stood higher than it had for more than a century; measured by all tests it stood higher than ever before.

CHAPTER IX

THE EARLY YEARS OF QUEEN VICTORIA'S REIGN

After the accession of Queen Victoria—A changed conception of Bank Rate—Mr. Goulburn's Conversion Scheme—The 1847 test—Mr. Gladstone's failure—Heavy demands for capital—The strands of international finance—"Roaring" prosperity—The Overend, Gurney crisis—The Leeman Act—Expanding gold output—Limited liability—The City of Glasgow Bank—Emergence of the Finance Company—Balance sheets: the 1862 recommendation

Our last chapter carried us through the brief reign of George IV and the briefer one of William IV, bringing us to the year immediately following the Bank Act, that is, to a point eight years after the accession of Queen Victoria. Whereas for well over a century before the passing of the Act, Bank Rate, or rather the then-named Discount Rate, had moved within narrow limits, such was not to be the case in future; for in the quarter of a century from the end of 1845 the Rate was to be as low as 2 per cent and as high as 10 per cent. The wide variation reflects the influence of the changed conceptions of the part which the Bank of England should play in regulating the financial mechanism of the City; it also indicates the response of the Bank to the requirements of financial laws but recently perceived. It had been commonly held until a few years before the passing of the Act that the rate of interest to be charged for the discounting of Bills, or for any other kind of accommodation, was something independently decreed by the mere exercise of the Bank's authority. The Bank was not regarded as the medium for the expression of guidance as to the rate of interest appropriate to be charged from time to time when all circumstances are taken into account. So it came to be a general opinion that the rate of interest for any kind of loan need in reality never be changed, an opinion which

gained in plausibility from the prevalence of an even Discount Rate over a very lengthy period. Indeed, at this date far removed from medieval times, the idea that a rate of interest could be fixed and maintained without reference to the supply of money and credit available still had a semblance of official approval in the shape of certain surviving usury laws which were unobserved. These laws stated what should be the rate of interest, but, plainly, when the Bank Rate unblushingly stood above the maximum rate of interest proclaimed by the surviving relics of outworn legislation, it was time for the latter to make an undignified exit. This happened in 1852; thereafter, we hear no more of a rate of interest fixed, as it were, for Eternity.

Mr. Goulburn's Conversion Scheme

From 1844 the Bank Rate was used for well-defined purposes, if not always with complete success, yet with no challenging failure. The Rate was raised with the object of attracting funds to London from abroad, and also of discouraging speculation by making borrowing dearer; it was lowered in times of bad trade in order to make borrowing cheap and so to reduce the loan costs of enterprise. The desirability of raising or lowering the Rate was determined over the next seventy years by the inter-related factors of the state of the foreign exchanges and the extent of the Bank's stock of gold. It should be interpolated that in 1844 Mr. Goulburn, the then Chancellor of the Exchequer, launched a scheme for the conversion of part of the National Debt to a lower rate of interest. At that time 3 per cent Consols were standing at slightly over 98, and it was therefore decided to endeavour to effect the conversion of about £250 millions of 3½ per cent stock by exchanging the existing stock for stock at par to bear a guaranteed rate of interest of 3¼ per cent for ten years

and thereafter 3 per cent guaranteed for twenty years. The guarantee of a rate of interest of not less than 3 per cent for thirty years appears to have been greatly appreciated, and the Conversion was an almost complete success, holders of only about £100,000 of stock declining to accept the conversion offer.

Bank Rate and Speculation—an Early Test

An opportunity to test the Bank Rate as a means of checking speculation soon came. In 1847 City bankers complained that they were subjected to an almost unendurable strain by reason of heavy demands made upon them for funds which were not being withdrawn for employment in healthy business, but for gambling in stocks and shares and in commodities. The situation was met by announcing that the Bank of England would, if it should seem expedient, increase its Note Issue beyond the limits prescribed in the Charter of three years before. Simultaneously with this intimation the Bank Rate was raised to 8 per cent, thus making onerous the fresh borrowing of money, because the Bank of England Rate now governed the terms of banking accommodation anywhere in the British Isles. Eventually, the joint stock and the private banks standardized their loan terms by charging 1 per cent above the existing Bank Rate, with a minimum of 5 per cent, excepting to a few specially favoured borrowers. It was not found necessary to increase the Note Issue, and the sharp rise in Bank Rate induced a sober state of the public mind and caused the crisis to subside.

Bank Rate was maintained at 8 per cent for a month only, and by January, 1848, it had been gradually reduced to 4 per cent. A high Bank Rate had at this time the advantage of novelty; possibly to this fact should be attributed some of its speedy efficacy. It was a time, however, when the surging industrialism of Great Britain

powerfully contributed to recovery from financial crises, as can be understood when it is known that the exports of home produce and manufactures increased from £66 millions in 1845 to £244 millions in 1870. But whatever the peculiar advantages Bank Rate may have enjoyed during the early days of its use as a restrictive or expansive arbiter, there is no doubt of its enduring influence in one degree or another upon the course of finance and trade. Our concern is primarily with the effect of Bank Rate upon prices of stocks and shares. This is a matter that, in its more fundamental aspects, would be better dealt with later, when we shall have become acquainted with developments which, if we were to anticipate them, would destroy the proportion of our inquiry. But we may now say, at the risk of over-simplification, that one effect of the raising of Bank Rate is to bring about a fall in the price of fixed interest stocks and shares, and one effect of the lowering of Bank Rate is to provoke a rise.

Mr. Gladstone's Failure

An increase in Bank Rate implies that borrowers, whether states or companies, will have to offer higher rates of interest if their wants are to be satisfied; accordingly, the prices of already existing securities fall, so that the yields returnable upon them approximate to those which can be obtained on fresh offerings. The fall is initiated by selling old stock for the purpose of transference, although the amount of new stock which can be bought for replacement purposes is equal to only a small portion of the stock previously created. A reduction of Bank Rate enables borrowers to satisfy their requirements at lower rates of interest; therefore, the Stock Exchange prices of securities issued in periods of a higher Bank Rate and carrying more interest appreciate so that the yield to be obtained upon the old securities differs but little, if at all,

from the yield offered by new securities of equal standing. Stimulated by Mr. Goulburn's success of nine years before, Mr. Gladstone in 1853 attempted to convert another portion of the National Debt into securities which were to bear a lower rate of interest. He proposed to the holders of the South Sea Annuities, including the capital stock of that company, on which the Government was paying 3 per cent, and to holders of some 3 per cent stocks dating from 1726 and 1751, that they should accept in exchange for each £100 certain other stocks. The scheme failed entirely, possibly owing to the complicated nature of the proposals. It may be noted that holders of South Sea Company securities absolutely refused the offer and were paid off at par, and from that time the title of a one-time famous joint stock concern no longer appeared in the yearly record of the National Debt.

Heavy Demands for Capital

A very heavy demand upon the capital resources of the country was made by the railway companies at about this time; the stock and loans of British railway concerns amounted to £88 millions in 1845 and to £240 millions in 1850, increasing to £530 millions in 1870. Some portion of this increase represents money obtained from banks and not direct from the public, but the amount obtained through new issues of stock represents by far the greater portion of the increase. Occasionally, extensive difficulties were caused by the necessity of making payments for the railway stock subscribed, but the difficulties were not as formidable as the figures of the large amount of stock issued might by themselves suggest. The explanation is that the savings of the British people available for investment were mounting rapidly each year as an outcome of Britain's pre-eminence as a manufacturing nation.

Indeed, within the period from 1845 to 1870 a much

larger amount of British capital was sent abroad than was absorbed by home railway companies. We cannot tell exactly what was the total of British capital which by the end of 1845 had been publicly subscribed for use abroad, but it was probably rather less than £200 millions. There is fairly definite evidence that twenty-five years later the sum was approximately £1,000 millions. Thus, the average amount of British capital subscribed yearly for home railways and for overseas investment from 1845 to 1870 was £48 millions. If we were to include that subscribed for miscellaneous home companies the annual average would be substantially higher; for between 1856 and 1870 it is recorded that over seven thousand new companies were formed with a nominal aggregate capital in the region of £1,000 millions, of which less than one-fifth was for home railways and only one-sixth for foreign enterprises. Not all of the £640 millions remaining can be regarded as new capital actually subscribed for home enterprises; for some of the enterprises failed without placing all of the capital which they had taken powers to issue, and some of the companies were merely conversions into public concerns of existing partnerships or private companies, no additional capital being provided. But when allowance has been made for these factors it remains that British investments in the securities of Governments and public companies must have been at the rate of between £75 and £80 millions per annum during the fifteen years to 1870.

Within this period the strands of international finance were added to and strengthened by improvements in communicative ability. The cable between England and France, completed at the end of 1851, made it possible for the opening and closing prices on the Paris Bourse to be known in London during the business hours of the Stock Exchange, and soon all the important stock markets of the Old World were to be similarly linked together.

"Roaring" Prosperity: The Overend, Gurney Crisis

The quarter of a century which we are now reviewing has been described as a period of "roaring" prosperity; certainly, with one exception, and the years of the Crimean War from 1854 to 1856, the few crises were largely manifestations of financial exuberance. The temporary effect of the Indian Mutiny was pronounced but not severe, the range of the price of Consols in 1857 being from $97\frac{7}{8}$ to $87\frac{1}{8}$.

The one exception referred to in the paragraph preceding occurred in May, 1866, when by the failure of the banking firm of Overend, Gurney & Co., Ltd., the City was subjected to the greatest financial strain it had so far experienced in time of peace, and to meet which the Bank of England advanced £45 millions in three months. In April the Joint Stock Discount Company had suspended payment, as had also Barneds Bank of Liverpool, the latter with liabilities of £3½ millions. But the liabilities of Overend, Gurney were for over £10 millions, and numerous firms with which Overend, Gurney were connected had to close their doors. Continental as well as British firms were involved, and it was the first instance in the nineteenth century of a business failure in one country having serious international reactions. We have seen that long ago Europe had been shaken by the fall of a famous Florentine banking house. Panic seized the City of London, and in the words of a spectator who walked through the City at that time "every banking house was surrounded by dense and struggling masses."

The collapse of Overend, Gurney was not entirely without warning; for the year 1866 had hardly begun before heavy withdrawals by depositors took place and the shares of the company fell sharply. Curiously, the liquidation of Overend, Gurney followed in less than a year after the turning of the concern from a private into a public

company, the public having subscribed £1,250,000 of the capital, while £250,000 of shares were allotted to the former partners. The shares were £50 each, of which £15 was paid on application, the remainder being a deferred liability. As a result of the failure the shareholders were called upon to pay another £25, making £40 in all. The liquidation of the affairs of Overend, Gurney took no less than twenty-five years to accomplish, during which the ordinary creditors were paid their claims in full and the shareholders were refunded £7 18s. 2d. of the £40 per share they had subscribed. The liquidators received nearly £72,000 for their work, and the legal costs were £52,000. So was the ancient saying confuted that out of nothing nothing comes, the reproach of the scandal of the law's delays justified, and a striking example provided of liquidation as a whole-time job. Mr. Lancelot Holland, the Governor of the Bank of England, expressed the opinion some months after the crisis that "the downfall of Overend, Gurney must be traced to the policy the directors adopted of paying interest on deposits at call while they were themselves tempted to invest the money so received, in speculations in Ireland or in America, or 'at the bottom of the sea' where it was not available when a moment of pressure arrived."

The Leeman Act

One of the by-products of the 1866 crisis was a large amount of speculation for the fall. Speculators had something substantial on which to base their hopes, but additionally many unfounded rumours questioning the stability of banking houses were spread by unscrupulous operators. As a result of these practices a short Act was introduced in 1867, later generally known as the Leeman Act, having for its purpose the amendment of the law in respect of the sale and purchase of shares in joint stock

banking companies. The Act contained a number of provisions to remove the possibility of "bear" sales of banking shares, and stipulated that any sale should be null and void unless the numbers of the shares were set out at the time of the making of the contract, or if the shares did not carry numbers, the name of the person registered as a proprietor who was seeking to dispose of his holding. The Act remains in force, but as a reserve power, and up to 1933 has never been applied in Great Britain, where it is to be hoped the sense of civic responsibility has become so great as to render the Act a dead letter. It may be noted, however, that often in times of actual banking nervousness public reference has been made to the provisions of the Leeman Act, and that in the great Australian banking crisis towards the end of the nineteenth century the Victorian Parliament passed similar legislation.

Expansion of Gold Output

Early in the period with which we are now dealing there was added to the urge and promise of industrial invention the stimulus of gold discoveries in California and Australia. The world's gold output during 1851 was two-and-a-half times the average of the preceding ten years; in 1852 it was four times that average, from which future recessions were slight, and at length a further great expansion occurred in the 'nineties as a result of the exploitation of the South African Rand. It was not the case that in the middle of the nineteenth century the relation between the nation's gold stocks and expansion or contraction of the volume of credit was as close as it was to be in later years; nevertheless, credit facilities did expand under the influence of the great addition to the permanent wealth of the world, while the amount of gold currency in circulation within the United Kingdom increased from £1 13s. per head of population in 1844 to £2 12s. per head in 1868.

The Principle of Limited Liability: The City of Glasgow Bank

The increased output of gold must therefore be regarded as having played an important part in widening the stream of investment; but the chief influence was the modification of the laws respecting the formation of joint stock companies. The most important of these modifications was recognition by the Government in 1855 of the principle of limited liability. A person subscribing for the shares of a limited liability company was liable in the event of that company's failure for any amounts unpaid on the shares he owned; but his personal estate was to be immune. Whilst the principle of limited liability had been recognized in the case of the chartered companies it had not been done so hitherto with regard to ordinary joint stock companies, whose shareholders were therefore in danger of ruin were the companies to fail with heavy liabilities. The Act was not passed without opposition; indeed, the Committee appointed by the Government to report on the matter had a majority against the innovation, the main objection being that it would weaken the sense of personal responsibility in the conduct of business. It may be remarked that the advocates of change included in their arguments the contention that industry was being handicapped by lack of capital through people being unwilling to face the possibility of being called upon to make good out of their private estates deficiencies of companies in which they were shareholders. A majority of the Committee declared that capital was in abundant supply. The principle made legal, most of the old joint stock companies hastened to become of limited liability and practically all new companies came into this category. Banking companies were an exception. It was thought that change to limited liability would undermine the prestige of banks, and so until 1878 shareholders in most of the banks, other

than the chartered, remained as partners with unlimited financial responsibility should the emergency arise. In 1878 the City of Glasgow Bank failed, and so heavy were its debts that the majority of the bank's shareholders were beggared when called upon to sacrifice everything in accordance with the non-limited constitution of the company. An idea of the terrible hardships caused by this failure will be gathered from the fact that in six months the unfortunate shareholders of the bank were called upon to pay £2,750 for every £100 of shares held, in order that funds might be provided to meet the liabilities of the bank. The shareholders included many highly respectable professional men of moderate means, and two hundred spinsters held an average of slightly over £240 of shares and, therefore, were each called upon to find £6,610.

It was realized in face of the distress so created that, whilst unlimited liability banking companies might gratify some depositors, apart altogether from the unfair results to shareholders the need of change was imperative; for the status of banks was not really raised by retaining this kind of association. A result of the City of Glasgow Bank collapse was that investors declined to accept the risks attaching to bank shares, which consequently became nearly unsaleable. Bank directors accepted the moral, and soon all joint stock banking concerns became of limited liability. There was, however, an arrangement for a so-called reserve liability, which eventually took the form of bank shares not being subscribed to the full denominational extent, the uncalled amount being demanded only in case of extreme necessity. But the buyer of a bank share had the advantage of knowing what would be the full extent of his liability, if the worst happened. This he did not know under the old state of affairs, unless he assumed that he would lose his all, which, as we have learnt

from the instance of the City of Glasgow Bank, did not enter into his calculations.

Emergence of the Finance Company

The principal structural change in company formation from 1845 to 1870 was therefore of universal character, but we have to note also the emergence of a new type of company, namely, the finance company. In 1852, there was formed in France the "Société de Crédit Mobilier," based on earlier Continental models but more ambitious than any of them. The objects of the Society included the subscription and acquiring by other means of stocks and shares in industrial enterprises. It was to do this chiefly through subsidiary companies formed for shareholding purposes. It was provided that the Society could issue its own obligations to the extent of at least the amount invested by the subsidiary companies formed for the acquisition of stocks or shares. The Society was to act as a banker for these enterprises, and also generally to undertake loans on securities, be the medium for the payment of interest and dividend, receive deposits, and open credits. The Society was at first very successful, and it was not long before it had its imitators in England. The activities of the Society were clearly of a very diverse character, but within them can be seen three main constituents—the issuing house, the holding and managing company, and the investment trust company, three types of concerns which were to play important parts in the joint stock history of the future. The English imitators of the Society seem to have concerned themselves chiefly with the financing of enterprises which were to be developed up to a certain stage and then floated as public companies. Whatever may have been the merits of this form of financing, the result was that companies were floated at excessive capitalizations on the strength of preliminary

work done by the aid of money so supplied, and the finance undertakings were reimbursed over-handsomely at the public expense.

Balance Sheets—the 1862 Recommendation

Balance Sheets at the time of which we are writing were usually unilluminating documents; the process of causing them to be otherwise was to be slow, and for long the State was not fully alive to the seriousness of the subject. The Government's attitude on this matter, until later in the century, was that the companies should mention in their Articles of Association, the kind of accounts which would be published; but there was no legal compulsion to do so. But although the Companies Act of 1862 left the directors of companies, as far as accounts were concerned, with much the same powers of concealment as before, the Act did contain a specimen Balance Sheet, the form of which was recommended as suitable for use where no provision had been specially made in the Articles of Association. The inclusion of a specimen Balance Sheet in the 1862 Act, accomplished little immediately, but it provided a touchstone for the criticism of the inadequacy of Balance Sheets, and so played a part in the eventual bringing about of reforms. The specimen Balance Sheet is reproduced on page 96. Possibly, the suggestions err on the side of recommending too much detail; from the investor's point of view the general scheme is to be praised. It may be specially noted that any debt due from a director or other officer of a company was to be separately stated: the desirability of such an inclusion was subsequently proved to the utmost by numerous unpleasant incidents. Few Balance Sheets of even fifty years later contained as much information as advocated by the Companies Act of 1862. Directors of companies sought refuge in the claim that a

JOINT STOCK COMPANIES ACT OF 1862

Form of Balance Sheet Suggested

Dr.	£	*Cr.*	£
I. Capital Showing— The number of shares. The amount paid per share. If any arrears of calls, the nature of the arrears, and the names of the defaulters. Particulars of any shares forfeited.		Showing Immovable Property Distinguishing— Freehold land. Freehold buildings. Leasehold. Movable Property Distinguishing— Stock-in-trade. Plant (the cost to be stated with deductions for deterioration in value as charged to the Reserve Fund or Profit and Loss).	
II. Debts and Liabilities Showing— The amount of loans on mortgages or debenture bonds. The Amount of Debts owing by the Company, Distinguishing— Debts for which acceptances have been given. Debts to tradesmen for supplies of stock-in-trade or other articles. Debts for law expenses. Debts for interest on debentures or other loans. Unclaimed dividends. Debts not enumerated above.		Debts owing to the Company— Debts considered good for which the Company holds bills or other securities. Debts considered good for which the Company holds no security. Debts considered doubtful or bad. Any debt due from a director or other officer of the Company.	
Reserve Fund Showing— The amount set aside from profits to meet contingencies. Profit and Loss Showing— The disposable balance for payment of dividend, etc. Contingent Liabilities Showing— Claims against the Company not acknowledged as debts. Moneys for which the Company is contingently liable.		Cash and Investments Showing— The nature of investment and rate of interest. The amount of cash, where lodged, and if bearing interest.	

Balance Sheet should not give information to rival concerns. The argument has force in a competitive world, but it may be remarked that the practice which the argument involves has a dissembling value in more ways than one, and therefore requires to be received quizzically.

CHAPTER X

NINETEENTH CENTURY CONTINUED—THIRD QUARTER

1871–1895—The price of Consols—"Current" securities in 1871—The New York panic—Select Committee on Foreign Loans—Statistics of default—The plague of Egypt—A Royal Commission on the Stock Exchange—Brokers and jobbers—Contracts—"Buying in" and "selling out"—Stock Exchange members as principals—The middleman approved

ONE feature is most persistent throughout the next quarter of a century of our inquiry, namely, appreciation in the Stock Exchange quotations of British Government Stocks. The reasons for the movement are outstanding; the explanation is primarily to be found in the course of commodity values. Prices of commodities rose during the first three years of the 'seventies; but thereafter declined almost continuously for many years. Sauerbeck's Index Number of Food Prices at our starting point of 1871 was 98, from which it descended to 64 in 1895, the closing year of our present survey. The decline in raw material prices was even more pronounced, the comparative Index Numbers for the same years as mentioned above being 101 and 60. Although lower prices for food benefited wage earners by increasing their purchasing power and lower prices for raw materials helped manufacturers to reduce costs of production, trade activity did not grow as it had done in the previous quarter of a century. British exports for 1895 were less in value than they were in 1881: the comparison of values has limitations, but it does indicate the existence of a lesser demand upon money and credit for trade purposes. An outcome of the inability to employ available funds adequately in commerce and industry was a great increase in purchases of Stock Exchange securities, and

whereas the highest price of 3 per cent Consols in 1871 was 94, the price of 2¾ per cent Consols in 1895 reached 114. The difference of ¼ per cent in the Consols last instanced proceeds from the fact that extremely favourable monetary conditions enabled the Government in 1888 to place on a 2¾ per cent basis £570 millions of Debt which had until then borne interest at 3 per cent. The lower yield obtainable on Government stocks in 1895 compared with that to be obtained twenty-four years earlier was more than compensated by the fall which had meanwhile occurred in the cost of living, and because also the total National Debt had been reduced by £140 millions in the period, or to £656 millions, a yield of only £2 8s. per cent on British Government Stocks was considered attractive even by conservatively minded bankers. Nevertheless, purchasers of 2¾ per cent Consols at 114 or thereabouts were making no allowance for a possible reversion of the commodity price movement or the development of more remunerative channels for the use of money.

"Current" Securities in 1871

A remarkable expansion of investment and speculative activity was evident at the beginning of our period. The total Stock Exchange clearings for the second half of 1871 amounted to £416 millions, an increase of £150 millions over clearings for the corresponding half of 1870. Inactive, or as they were then called "non-current," stocks and shares were numerous; but it will serve to show the importance which the Stock Exchange had acquired if we outline the types of securities which were "current," that is, active at this time. The securities referred to in the next paragraph were of this kind.

British Government Stocks bore interest ranging from 2¼ per cent to 5 per cent; twelve Indian Government Stocks from 4 per cent to 10 per cent. Foreign and Colonial

Stocks were dealt in extensively, Russian, Turkish, and Egyptian securities being especially prominent among the former. Included in the foreign government stocks were six kinds of obligations of the United States Government and those of a number of the American States. The total of American Railroad Stocks was fifteen. We may note the debentures of eight Indian railway companies, the principal and interest guaranteed by the Secretary of State for India in Council, and also the Ordinary Stocks of the East India, the Great Indian Peninsular, and the Madras Railways. Grand Trunk of Canada and Great Western of Canada were chief among colonial railway stocks. The market for foreign railway stocks reflected a now almost forgotten phase of British finance, and we find such continental names as Antwerp and Rotterdam, Belgian Eastern Junction, Dutch-Rhenish, Great Luxembourg, Lemberg-Czernowitz, Lombardo-Venetian, Namur and Liége, Sambre and Meuse, together with the Brazilian San Paulo Railway. Sixteen Home Railway Ordinary Stocks were favoured. Bank shares amounted to 51, Telegraph to 18, Gas to 17, and there were 5 Dock concerns. Among the nearly ninety miscellaneous companies were to be found the Berlin Waterworks, Bolckow Vaughan, Canada Company, Crystal Palace, Fore Street Warehouse, Hudson's Bay, India Rubber and Gutta Percha, London General Omnibus, Rhymney Iron, Royal Mail Steam Packet, and several tea companies. Mining shares included a number of Cornish tin companies, the Cape Copper, and St. John del Rey. The art of creating classes of stock or shares to rank in front of Ordinary securities had become both skilful and respectable. A Midland Railway shareholder who in 1871 had the temerity to disapprove of the issuing of Preference Stock to rank in front of the Ordinary was castigated for not being up to date in his notions.

The rising tide of Stock Exchange activity was checked in 1873 by a financial panic in America, which caused the New York Stock Exchange to be closed for ten days. The check was of brief duration and the investing of British money in America soon resumed, the Scottish American Investment Company being formed for that purpose in 1873, and the Scottish American Mortgage Company in the year following, while in 1879 were formed the First, Second, and Third Scottish American Trust Companies and the American and General Trust Company, all of which were vigorous half a century later.

The 1875 Select Committee on Foreign Loans

In 1875 the Government appointed a Select Committee to inquire into the circumstances attending the making of contracts for Loans with certain Foreign States, and also the causes which had led to the non-payment of the principal and moneys due in respect of such loans. The inquiry was concerned with loans of a nominal value of £10 millions raised by Honduras, San Domingo, Costa Rica, and Paraguay. The Committee came to the conclusion that those who introduced these loans to the public seemed to have been regardless of the financial resources of the borrowing States, and they commented upon the absence in the evidence of the members of the Stock Exchange of any very keen appreciation of the evils of manipulating loans and of any fertility of resource in devising remedies.

It was customary for syndicates to be formed to take portions of the loans at a price considerably below the issue price to the public, these portions being sold directly a market had been created in the loan. Sometimes the contractors for the loans employed brokers to buy and sell the loans before any allotment had actually been made, the prices recorded of dealings in the loans being therefore

entirely fictitious, since no money had been subscribed for the loans and none had passed in the alleged transactions. The Committee censured loan contractors, or as we now call them issuing houses, and certain brokers much more severely than they did the defaulting Governments; for the Committee could not fail to recognize that the agreements to which representatives of the borrowing Governments had put their signatures left a good deal to be desired in the way of soundness. Honduras became indebted in respect of a principal sum of £5,990,000, and in return for the liability secured an abandoned section of a line of railway 53 miles in length for which the builders received £689,000. The Committee remarked of San Domingo that "it is clear the Republic felt the improvidence of a bargain by which in return for a sum of £320,000 it was to pay in respect of interest and sinking fund annuities amounting to a total sum of £1,472,500, or in other words, more than 18 per cent per annum for twenty-five years."

Statistics of Default

The loose practices and definite abuses in connection with the above loans deserved exposing, but it may be doubted whether it was worth the year or more which the Committee spent in examining multifarious details and in trying to persuade unwilling witnesses to appear and confess. A much more important subject than that of these comparatively paltry loans to a few minor and, as the evidence showed, then rather comic opera states,

Total British Loans to Foreign States at the end of 1878—

	£	£
All Obligations Fulfilled		281,828,000
In Partial Default	175,160,000	
In Total Default	157,000,000	
		332,160,000
		£613,988,000

was the whole question of foreign investment. That lending abroad was far from cautiously carried out is to be seen from the compilation given on page 102 made by a London stockbroker three years later.

It is shown by the above that default or partial default had occurred on 54 per cent of Britain's Loans to Foreign Governments. Possibly, so large a proportion of the money which Britain lent abroad was used to buy her manufactures that, viewed from an entirely national standpoint, defaults or partial defaults on foreign loans were of less consequence than they appeared to be and what was lost in one direction was made up in another. It is not for us to indulge in polemics on this question, but it cannot be overlooked that not all of the money sent abroad in this fashion came back to Britain in due course. The face of matters suggests that the retention of some of the money for the purpose of improving home equipment and expanding home consumption would have been distinctly less unprofitable in the long run than the relegation of capital to distant lands and to the pockets of seekers after commissions.

Egypt as a Borrower

The subject of foreign loans cannot be left without a rather lengthy reference to the experiences of Egypt as a borrower; in order to do so we start a little before the opening date of our chapter. That the narrative may be continuous we carry the story on to 1882, without interrupting by reference to other matters which also happened in the years covered.

In 1868 the Corporation of Foreign Bondholders was formed, and the Rt. Hon. G. J. Goschen, who was in the chair, announced his belief that the duties of the association were to be most important, and that they could be used to great effect by exercising a moral power over the

British Government, which was to be induced to use its "good offices" when that seemed a desirable course. This anticipation of a closer connection between foreign policy and international finance was duly realized; as it happened, in the very year that Mr. Goschen made his announcement, the ground was being prepared for the eventuating of a state of affairs wherein the British Government was to use its good offices in unmistakable form.

It was in 1868 that a 7 per cent Loan for nearly £12 millions was issued on behalf of Egypt at a price of 75, the Khedive of Egypt undertaking that his Government should not issue another public loan, either internally or externally, for the space of five years. Two years had not elapsed after the date of this undertaking when the Egyptian Government issued another 7 per cent Loan, the amount on this occasion being over £7 millions and the price of issue 78½ per cent. Therefore, the Egyptian Government was rewarded with slightly better terms for breaking its pledged word.

The Egyptian Government could not be held entirely responsible for its defections; the Khedive was besieged by representatives of British, Continental, and Egyptian financiers all urging him to borrow money by their kindly aid. These philanthropic endeavours culminated in the attempt during 1873 to float at 79 a 7 per cent Loan of £32 millions, the London firm of Bischoffsheim & Goldschmidt, already prominent in connection with South American Loans, and the Société Générale being the prime movers. A 7 per cent Loan offered at 79 per cent returns a flat yield of just under 9 per cent to the purchaser; in other words, that is the yield irrespective of any conditions of redemption which may attach to the Loan. This was a tempting yield; but it lacked the attraction of novelty, the return on the Egyptian Loan of 1868 being a shade over 9 per cent. Besides, a £32 millions Loan was a flagrant instance of

over-reaching. Consequently the Loan was only partly subscribed on the prospectus offer; but the clever sponsors managed to get rid of the remainder in other ways. Notwithstanding the size of this Loan, two years later the Egyptian Government borrowed a further £4 millions.

The Suez Canal Company

The financial excesses of the Egyptian Government gave to Britain an opportunity which has provided a theme for much writing of fiction, namely, the acquisition of the Egyptian Government's shares in the Suez Canal Company. The total capital of the Suez Canal Company was then £18,880,000, part of the capital consisting of 400,000 shares of 500 francs or £20 each. It was 176,602 of these latter which passed to the British Government and, since immediate action was required lest other would-be purchasers entered the field and outbid, the sum of £4 millions needed was advanced to the British Government by Messrs. Rothschild, Lord Beaconsfield subsequently obtaining a Parliamentary grant for the amount required. The shares thus purchased were not entitled to any dividend until 1894, the Khedive having surrendered the dividend rights for 25 years from 1869 in settlement of certain claims against him by the Suez Canal Company. It was part of the conditions of the British Government's purchase of the shares that the Egyptian Government should pay interest at 5 per cent on the £4 millions provided until the shares were again entitled to dividend. The market value of these shares on 31st March, 1914, was nearly £35 millions.

Concurrently with the handing over of the Canal Shares the Khedive requested the British Government to send a special Commission to inquire into the conditions of his country's finances. The Commission came to the conclusion that "the critical state of the finances of Egypt is due to the combination of two opposite causes. She suffers from

the ignorance, dishonesty, waste, and extravagance of the East, and at the same time from the vast expense caused by the hasty and inconsiderate endeavours to adopt the civilization of the West." But the Commission added that Egypt's unfortunate position was also due in great measure to the onerous conditions of the Loan of 1873. Severe comment was made upon the exorbitant profits of the loan contractors, and it was stated that when allowance was made for commissions, discounts, etc., the sums which actually reached the Egyptian Government as a result of the Loans meant that the interest rates were from 12 per cent to 13 per cent. It was revealed that all of the nation's revenues had been pledged "sometimes more than once" to meet the service of the Loans and fresh debt raised in an effort to meet the requirements of debt formerly contracted. The Commission made various recommendations for the reform of the Debt, but the reforms were found to be impossible of carrying out owing to the opposition of the French holders of Loans for comparatively short periods, to which type of Loan the Egyptian Government had also committed itself heavily.

The rest of the story is to be found in every English history book. Suffice it here to remark that in 1879 the Khedive dismissed the French and English Finance Commissioners who had been appointed as a result of Egypt being declared bankrupt. An ultimatum from England and France followed. Three years later occurred Arabi Pasha's rebellion to liberate Egypt from European influence, and after that the bombardment of Alexandria by the British Fleet.

The 1878 Royal Commission on the Stock Exchange

We return from the Land of the Pharaohs to find ourselves in the year 1878, that is, three years after the Select

Committee on Foreign Loans finished its labours. Yet another official inquiry had begun; the subject on this second occasion being the working of the Stock Exchange, and the investigating body a full-blooded Royal Commission. The Commission went to great pains in the examination of witnesses, but in the end suggested little improvement of the way the Stock Exchange managed its business. Indeed, the Commission confessed to an agreeable surprise at the degree of discipline and efficiency maintained by the Stock Exchange Rules and Regulations. It did, however, with one dissentient, recommend that stocks and shares should not be dealt in before allotment, but this recommendation, designed to prevent the rigging of markets, was not carried out. Fifty years were to pass before the much-needed reform was introduced.

Evidence given to the Commission furnished the curious sidelight that persons were practising as stockbrokers under a licence from the Corporation of the City of London, although they were not members of the Stock Exchange. It may be recalled that according to an Act of some hundred and eighty years before this time all brokers were supposed to be so licensed. The stipulation had never been taken seriously by those who gathered in Capel Court, or in the earlier venue of the Royal Exchange.

When the Commission met in 1878 some of the holders of Stock Exchange shares were not members of the Stock Exchange, but it had been decided by the Stock Exchange Committee in a new deed of settlement in 1876, that no new shareholding would be allowed unless on the part of a member. It was also provided that the maximum number of shares to be held by a new member should be ten. Thus the path was prepared for the gradual disappearance of subscribers and the making of control of the Stock Exchange, both as to finance and routine, a concern of members only. The average annual dividend of the

Stock Exchange since its existence as a joint stock undertaking, that is, for approximately 75 years to 1878, had been from 20 to 21 per cent; the market price of the shares, on which £54 had been paid, was £160 at the time of the Commission.

Brokers and Jobbers

A considerable part of the Commission's Report was devoted to a description of the duties of broker and jobber and to details of Stock Exchange procedure under certain circumstances. There are, said the Report, two classes into which members of the Stock Exchange divide themselves: the brokers, who receive instructions from the public to buy and sell on their behalf, and the jobbers, who buy and sell on their own account, with the view of selling and buying again. The jobber remains in the "House," that is, the Stock Exchange Building, ready to deal with anyone who comes to him, the broker comes into the House only when he has business to transact. It is the custom that these jobbers should, as it is called, "make a price" in any current securities, that is, securities of which there is a large amount, and for which there is an active market. "Making a price" consists in stating two prices, at one of which the jobber binds himself to buy and at the other of which he binds himself to sell the securities in question. There are by the Rules limits as to the amount in which he is bound to deal. After the jobber has "made his price," the broker announces himself as either a buyer or a seller at the prices named, and the jobber is bound to accept the contract. As soon as the contract is made, it is usual, but not universal, for each party to make a note of it in his own notebook, but no written contract passes between them. "We are assured," remarked the Commission, "that the want of a written contract has in practice no evil results; that out of millions of contracts made on

the Exchange, such a thing is hardly known as a dispute as to the existence of a contract or its terms." The broker who has acted for his client in making such a contract sends a written note of it to the client, but as a rule he does not mention the name of the dealer with whom he has dealt. The large majority of the contracts are made upon the terms that they shall be fulfilled on the next Account Day. There are two fixed Account Days in every month for stocks other than Government Stocks, these latter being settled only once a month. When the Account Day arrives the securities are delivered and paid for, unless some fresh bargain is made by which the execution of the contract is annulled or practically deferred until the next Account Day. If the bargain, however, is completed on the original Account Day, it is not necessarily carried out between the original parties to it: for the seller may have bought similar stock from some third person, and he in like manner from another, and so on through several hands; so that the whole series of bargains is settled by the ultimate seller delivering to the ultimate buyer. The machinery by which this is managed, commented the Commission, is to be found in the Stock Exchange rules applicable to this subject, the detailed and minute provisions of which are the result of long practice and careful amendment, and appear to answer their purpose exceedingly well.

"Buying In" and "Selling Out"

If, when the Account Day arrives, the seller is not able to deliver the stock which he has sold, the buyer is entitled, after a certain lapse of time to "buy the stock in" against him. This proceeding is also regulated by minute rules, and consists in an official broker announcing on the market that he wants the given quantity of stock together with the purpose for which he wants it. When he obtains

it, the original seller has naturally to pay any difference in price, but it not infrequently happens that the official broker has to wait for some time before the jobbers will sell to him under such circumstances, and it may be doubted whether the system might not be improved by his being allowed to purchase either publicly or by private contract. Similar rules and a similar practice prevail with regard to "selling out" in the case of non-acceptance by the buyer. Excepting that eventually there was no separate Account Day for Government stocks, the practice of the Stock Exchange in the respects enumerated above remains in 1933 as described in the Royal Commission Report of 1878, with the "buying in" and "selling out" of shares rigid in theory, but scarcely so in practice.

It was in 1878, as afterwards, a principle upon which the governing body of the Stock Exchange acted throughout their rules in respect to bargains, that members should be entitled to look to the members with whom they dealt as if they were principals in those dealings, and as if the principal outside the House, for whom bargains were made, did not exist. This view has the merit of enabling the Stock Exchange Committee (who have absolute power over their own members) to enforce bargains and adjust disputes with speed and facility. The Royal Commission concluded that the public is not injured by such a system, so long as the *legal* rights and liabilities of the seller or buyer, as the case may be, in relation to the principal outside on whose behalf the bargain has been made, are not extinguished or interfered with. But the Commission had no hesitation in recording its opinion that if a client or principal outside the Stock Exchange employs a broker to make a contract for him with a jobber or broker in the House, no rule of the Stock Exchange ought to be allowed to qualify or destroy the legal relations of buyer and seller established by such a transaction, whether the Stock

Exchange Committee for the purpose of their own intervention acknowledge the principal or not.

The Middleman Approved

It had been suggested that the jobber was an unnecessary middleman, as perhaps it has been suggested in every year since. The reply of the Commission to the suggestion was unequivocal. It stated that the jobbers constituted a class which is a distinctive feature of the London Stock Exchange; and that there was no parallel on the Foreign Bourses or on any of the provincial Stock Exchanges. The existence of jobbers, declared the Commission, is of extreme value to the public. The jobber is ready to take at a moment's notice, almost any quantity of a current security with the knowledge that he can, perhaps within the same day or at any rate before the next Account Day, sell the same again at the margin of profit which is involved in the difference between the two prices that he named, and he acts without hesitation upon this facility. The result to the public is that the buyer or seller can make his bargain at once without seeking out some one else who wants to buy what he has to sell, or who wants to part with what he wants to buy. "So great is the accommodation provided by the system that purchases required on the provincial exchanges or the Foreign Bourses are constantly sent to London to be made on the Stock Exchange there."

Our chapter ends with this impartial testimony to the value of the jobber. But the Commission gave attention to one other thing which must occupy our attention, namely, speculation. We pursue the subject at some length in succeeding pages.

CHAPTER XI

MOSTLY OF SPECULATIVE PRACTICES

An ancient error avoided—The jobber's risk—The rightful censure of speculation—The important distinction—The gambler—Cash bargains, differences, contangoes, and backwardations—An impracticable demand—A question answered—Verve and agility—The put and call—Rare gain—Something to keep in mind—A banking discovery—A danger signal

What the Royal Commission on the Stock Exchange discovered with regard to speculation was mostly nothing new; but it did not fall into the ancient error of believing that speculation could be eliminated by Act of Parliament; far from this last, it recognized that attempts by men to capitalize chances were inevitable and in a number of directions communally desirable. The State at the time when it most condemned speculation was itself raising money by Lottery Loans, but as this means of adding to the National Debt had been abandoned in 1825, the Royal Commission of 1878 was under no necessity of polite reference because of the shortcomings of the Government in power. "There is speculation in almost every market," said one of the witnesses summoned by the Commission: "in produce markets there is speculation and where there is not speculation there is a dull market, in which you can hardly do anything: you cannot sell or buy where speculation goes out of a market, there is always a difficulty in making contracts." Incidentally, this witness truly observed that the absence of jobbers would result in the anxious seller being in the hands of the coy buyer, or the other way about.

The Jobber's Risk

It can readily be seen that the willingness of a jobber to make prices is dependent upon the exercise of the speculative spirit. If, for instance, the jobber were to refuse to

make an offer for the share of a company or the stock of a Government whenever national or local uncertainty prevailed, then freedom of dealing in securities would speedily come to an end; actually, it is only on the rarest occasions, such as of suspected fraud or the outbreak of war, that the jobber declines to name a price. Under all ordinary circumstances the jobber estimates the chances and takes the risk that his appraisal may prove to be at fault; by so doing he establishes a breadth of marketing facility which would be impossible were Stock Exchange transactions carried out only on the basis of the known present or the foreseeable future. Looking at the matter in the light of the deeper implications of philosophy, the uncertainties of human life are bound to be reflected in all manifestations of human activity, mundane as well as ethereal. Man, by the nature of things, is as much destined to move about in financial hopes and fears not realized as in worlds of that Wordsworthian kind.

Rightful Censure of Speculation

The rightful censure of speculation turns largely upon definitions. Professor Marshall declared that many of the largest fortunes are made by speculation rather than by truly constructive work, and added that much of this speculation is associated with anti-social strategy. It is clear that what he had in mind would better be described as manipulation, and especially the cornering and artificial raising of prices of securities or commodities. Even Governments through their agents force up the prices of certain securities when preparing the ground for the issue of a fresh loan or for Conversion operations, and Governments have also on a number of occasions sought to carry the prices of commodities higher. So far as manipulation is concerned, the purist will condemn Governments and individuals resorting to it. But inasmuch as purists are

rare, manipulation of Stock Markets by powerful Governments seldom agitates the public mind.

The Important Distinction

The important distinction between the speculator and the manipulator is that the one endeavours to anticipate the outcome of the working of financial and economic laws, and the other endeavours to prevent their operation until his own ends are satisfied. Whether the speculator sees the first faint shadow of approaching disaster and sells before the calamity descends in full force, or whether he senses the coming of better things and buys while prices are yet low, is, in the long run, at least a neutral act in its bearing upon the welfare of his countrymen. Conceivably, however, speculating for a fall or for a rise may give to the social organization a much-needed element of proportion; the action of the speculator tends to deliver business from the tyranny of considerations of the moment and to remind men that the future has to be reckoned with, although it cannot be precisely determined. If it were not for the influence of the speculator, fluctuations in the prices of stocks and shares would be more disturbing; for the immediate good news would not be tempered practically by allowances for the arrival of the distant less good, and the weight of the immediate bad news would be unrelieved by the recognition on the part of some buyers that modifying factors would probably become operative at a point near or far removed.

It must be understood that speculators differ very much in the amount of skill and knowledge which they possess, resembling in this respect the members of other callings. Some are men with a close grasp of economics and well acquainted with the lessons of financial history, while others, more particularly those of Jewish birth, act almost instinctively. Both types of men are to be found at the

centre of finance as speculators in the meaning of the remarks preceding, where speculation was defended as of social value. What lesser men do in the name of speculation would be unprofitable for us to examine, because, as we know, principles should be tested where they are best expounded.

The Gambler

The speculator, even at his weakest or most ill-informed, should not be confused with the gambler. It must be admitted that the Stock Exchange attracts gamblers from all sections of Society. The gambler buys securities for the slenderest of reasons and often for no reason whatever. He is the prey to rumour and the dupe of the machinations of the unscrupulous; he will buy because the day is sunny or sell because the sky is overcast. The activities of the gambler do not really come within the history of investment or speculation; but as the gambler makes his presence felt, sometimes uncomfortably so, we are not allowed to assume that for our purposes he does not exist.

Cash Bargains, Differences, Contangoes, and Backwardations

It cannot be said that a majority of members of the Stock Exchange desire the disappearance of the gambler. The commission charges which the gambler pays amount to a considerable sum before he becomes disillusioned or penurious or both, and always there is another generation springing up, inexperienced and eager to plunge where its fathers came to grief. Sometimes, however, gambling on the Stock Exchange reaches such threatening dimensions and causes unpleasant results to so many people that restriction of the means for using the Stock Exchange is urged by prominent persons, among whom may be numbered those stockbrokers whose clients are of a substantial

and sober kind. Such was the case in the period now under examination, and we find it advocated in 1875 that all bargains should be for cash only. As we have seen, with the exception of Government securities, settlements on the Stock Exchange were twice monthly, one of the consequences being that numerous purchases were made in the hope that prices would rise before payment was required, so enabling the pocketing of a difference without any outgoing having actually to be made. Conversely, sales of shares not in the possession of the seller were made in the belief that purchase at a lower price would be feasible before the date of the Account; if the belief were justified this also would have resulted in the making of profit without the outlay of capital. But rises and falls in prices of stocks and shares seldom occur so conveniently, and machinery had to be devised to meet the need of buyer or seller whose plans had miscarried. This was done by means of the contango in the case of the buyer of securities who wishes to postpone the date when he should be called upon to take up his purchases, and by the backwardation where a seller seeks to postpone delivery of the shares he has sold. In each case it means that a consideration is paid for the privilege of delay; but it should be said, in order to prevent misconception, that both contango and backwardation are governed by general market considerations, neither being invariably paid, but the contango has usually to be met.

An Impracticable Demand

The demand of would-be reformers of the 'seventies that all Stock Exchange dealings should be for cash was impracticable, if only from the reason that the granting of credit is inseparable from nearly all important business transactions; payment for purchases in one direction is dependent upon receipts from sales in another; it is

impossible to synchronize all payments and all expenditures. Additionally, if a fall in price makes a share attractive, it would serve no vital purpose to prevent a would-be buyer from purchasing because he could not secure the necessary funds for some days, and the prevention would embarrass the person urgently desiring to sell by depriving him of prospective purchasers. Time bargains are not merely expedient; they are based on a sound principle.

A Question Answered

With regard to the desirability or otherwise of insisting on the completion of all transactions on Account Day, the question is answered by the fact that no such stipulation could be enforced. The granting of carry-over facilities has had regrettable results in some directions; but, on the other hand, accommodation is an essential part of business procedure. If the Stock Exchange had not evolved the method of carrying-over in return for an agreed consideration, the omission would have meant that some buyers would have been in a position to negotiate for accommodation, and others would not or would have been able to do so only upon onerous conditions. An established procedure with a published rate of the consideration chargeable is much the fairer method.

Nevertheless, carry-over facilities are rarely required by the investor; they are most advantageous to professional operators, giving more verve to the "bull" and greater agility to the "bear." The charge made for contango is related to Bank Rate and also to the condition of Stock Markets. When the supply of a particular stock or share is scarce, the "bull" who has bought heavily may have a consideration paid to him not to press for delivery, although the state of his affairs is such that he has no cash available to take up stock. But such an event is exceptional.

THE "PUT" AND "CALL"

The taking of options had become a common practice by the 'seventies, and we find quotations for the "put" and "call," jointly and dissociatedly. The "put" and "call" meant the taking or delivery of stock or shares at a fixed price on a future date, for which right an agreed sum was paid when the option was negotiated. The "put" option by itself entitled the holder to deliver a specified amount of securities at a specified price on an agreed future date; the "call" option by itself was similarly determined but gave the right to claim stock. Options were from day to day or, much more commonly, from Account Day to Account Day; naturally a higher price was paid for the "put" and "call" option than for the "put" or the "call" only.

A certain amount of refinement and extension of option dealing has taken place since those days, and six weeks or three months have become the favourite durations. But the three principal forms of option dealing remain in essence much the same. This is not the place to discuss at length the respective merits and demerits of the different forms of options; it is evident that the "put" and "call" gives a double chance; against the advantage has to be set the fact that the price charged for this kind of option is usually double that for the "put" or the "call." It must be explained for the sake of clearness, that the term "put and call," although it has passed into the Stock Exchange vocabulary, is really misleading, if not contradictory, for literally it means the right to take and to deliver securities, whereas the option money has been paid for purchase of the right to pursue whichever of these courses is desired. Obviously, both to take and to deliver securities under the option would result in a balancing of the transaction. The option holder's ambition is gain, not the maintenance of an equilibrium.

Option Holders' Rare Gain

However, according to contemporary writers, gain seldom came the way of option holders in mid-Victorian times. It may be added that his twentieth century successor, if he is a member of the ordinary public, usually fares no better. The profitable handling of options demands the ability to discern some weeks ahead of their occurrence that blessings or ills are on the way for a company or a country, either from special reasons or because the general state of commerce is to experience a change for better or worse; or it may depend upon the possession of knowledge that powerful financial groups are planning to raise or to depress the prices of securities selected for that purpose.

Something to Keep in Mind

That options exist should be borne in mind even by the investor who has no intention of adding to the income of the option dealer or, for the matter of that, of the broker, since options have to be bought through the latter, he receiving a commission for his services. The option dealer stands to the broker in similar relation to that of the jobber. Options are a perpetual weapon in the armoury of the professional "bulls" and "bears" who endeavour to drive prices this way or that. The investor will be spared perplexity, if not anxiety, if he is cognizant of influences which bear upon the Stock Exchange quotations of his holdings—influences which may have little to do with the actual merit of his securities. Not even Trustee securities are immune from these influences; the Stock Exchange rules restrict the taking of options over this type of securities, but the ability to conclude them is not entirely removed. Then, too, although the existence of large options linked to hopes of the rise or fall of certain kinds of securities may be of irrational origin, there is the

possibility that the options indicate anticipations of well-informed Stock Market operators. The prudent holder of securities affected should not entirely ignore this possibility.

A Banking Discovery: Advances in 1888

It is easy to ascertain with regard to the Stock Market as a whole whether a large number of options are being taken for the rise or for the fall, since in the former case the contango rate will be comparatively high and in the latter the contango rate will be low or, if "bears" are strongly in evidence, there will be a backwardation. What cannot be ascertained is the amount of securities held as a result of borrowing from banks and other financial institutions. Securities thus purchased are liable to be flung on the Stock Market in the event of widespread demand for repayment of loans, as not infrequently happens when the lenders deem it wise to adopt extreme measures for the safeguarding of their positions. The pledging of securities with banks by all sorts and conditions of men and women in order to buy other securities is a practice which developed enormously in the twentieth century. The practice was not a ruling passion from 1870 to 1895, although the tendency became more marked as the years passed. But the banks had already discovered how extremely profitable it is to lend to the professional Stock Market operator, and in 1888 we find the banks for some time almost lavish in their advances for this purpose. It was a time when contango rates were very high, speculators for the rise paying as much as from 7¾ per cent to 15 per cent, according to the nature of the security carried over. Whilst some of the lending by the banks was directly contango, the greater part of it was to stockbrokers, who in turn lent to the jobbers; therefore it must not be thought that the full benefit of the high

contangoes was reaped by the banks. Nevertheless, when all allowance is made, the remuneration coming to the banks from this form of lending was temptingly large, particularly as the period was one of low yields on investments, Home Railway Ordinary Stocks returning on an average $3\frac{3}{4}$ per cent and British Government Stocks nearly 1 per cent less.

A Danger Signal

But the high contango rates, profitable as they were to the banks either directly or indirectly, were also a danger signal. This last being so, it is not surprising that before the year was out some of the would-be borrowers on securities were received by the banks in much the same way as is the young badger when its parents have decided that it is time for the young hopeful to fend for himself. In other words, the banks suddenly declined to acknowledge any kinship with Stock Market operators, new loans on securities became extremely difficult to obtain, and old loans were peremptorily called in. The banks, declared critics in those days, first inflated the Stock Markets by rather happy-go-lucky lending and then deflated them by pursuing an opposite policy at a moment's notice, ruining a number of people by the precipitate action. It was a complaint which was to be reiterated regularly over the next forty years. We had perhaps better not express an opinion on the merits of the criticism, but content ourselves with the observation that much could be said on both sides.

CHAPTER XII

1871 TO 1895 CONTINUED—THE INVESTMENT TRUST COMPANY

THE investment trust company—Scottish precept and practice—A striking example—A changed outlook—Scepticism in 1888 and 1889—Errors of policy—Over-purchasing in 1890—Publishing investment holdings—The fixed trust

THE years with which we are still dealing, the years, that is, from 1871 to 1895, were characterized by, among other things, the rise of the investment trust company. As we have already seen, this type of concern had its forerunner quite early in English joint stock history, the directors of the so-called Million Bank having perceived at the beginning of the eighteenth century the advantages of investing funds in several companies, thereby lessening the risks attaching to the employment of the Bank's capital. But at the time of the Million Bank's existence, and for long afterwards, stocks and shares available for investment were few; therefore, conditions were not propitious for any important development of the investment trust movement, the origin of which, in the modern sense, we can date from round about 1870. The fundamental principle of these trusts is simple and uniform; the directors obtain, let us say for example, £1,000,000 of capital, which is subscribed by members of the general public or by the directors and their friends; the money thus provided is used to purchase the stocks or shares of numerous governments, municipalities, or companies. It follows that the holder of shares in an investment trust company is really taking an interest in the fortunes of various States, towns, and industries, and that his risk is spread over a very wide area. He may be what is virtually a holder by proxy of an interest in several hundred different

securities; indeed, investment trust companies have been known with a thousand different stocks and shares in their portfolios.

Scottish Precept and Practice: A Striking Example

The investment trust companies of the late 'sixties were in several instances not conducted on such a definite line as that we have indicated, and the directors' indulgence in miscellaneous financial operations was the subject of a good deal of adverse comment. But largely under the guide of Scottish precept and practice stricter conceptions of the legitimate field of the investment trust company soon prevailed. The remarkable success attending the ablest managed of these companies is perhaps best shown by the case of the Scottish American Investment Co., Ltd., founded in 1873. Mr. George Glasgow has given a calculation of what would have been the results accruing to one who in 1873 had invested £1,000 in the Ordinary Stock of that Company. "Assuming," says Mr. Glasgow, "that he held his stock, never adding another penny to it; that he took up and kept his bonuses; that he exercised his rights to new capital by borrowing from his bank and then selling enough of the resultant new stock to repay the bank—assuming, in short, that he did not put any of his benefits into the waste paper basket (a contingency not unknown to experience, surprising as it may be), that happy investor's original £1,000 would in 1929 have been worth about £70,000, and his income would have risen from an original £40 a year to £3,000 a year in 1929."

The achievements of the Scottish American and similar concerns in the first few years of their existence were sufficiently striking to attract attention, and between 1879 and 1883 a number of investment trust companies were formed. These were years of general commercial

prosperity, favouring the financing of new ideas. Even so, the possibilities of investment trusts were not widely appreciated, and the capital found for them in the five years last named mostly came from small groups of people. The companies were formed in a period when high rates of interest were obtainable on good-class securities, consequently there was no difficulty in employing funds profitably. In 1888, with few exceptions, the investment trusts then in existence were paying from 5½ per cent to 6 per cent on their entire capital, of which the Preferred capital usually received 5 per cent and the Deferred or Ordinary 6 per cent or 7 per cent, but in that year the whole outlook for returns on investments underwent a radical change, the full nature of which was far from generally realized. It was the year in which Government financial policy brought about a fall in interest yields, making it impossible for a long time ahead to use new money at the former rates of interest, at least with anything like the same measure of security. Nevertheless, fifteen new investment trust companies were formed in 1888 with a capital of £9,500,000 and another nineteen in the following year, the capital of the last amounting to slightly over £25 millions. The total capital invested in this class of company at the end of 1889 was nearly £50 millions.

Scepticism in 1888 and 1889

The formation of the 1888 and 1889 companies was the occasion for the exercise of contemporary scepticism, it being suggested that directorship of an investment trust company was a convenient way of adding to one's income and that the investor, instead of providing money for a trust company and trust company directors' fees, would be well-advised himself to undertake the distribution of his money. Certainly, directorships in the Victorian era

were often bandied about in much the same way as were the congenial livings of the Church, with little regard to the merits of recipients, the pompous ass or the wire-puller securing preferment while better men languished. But it must be admitted that, with the investment trust companies, the shafts of criticism did not in every case go home. As it happened, the management of these companies passed into competent hands as often as one could reasonably hope in a notoriously imperfect world. Mistakes were made; many companies, however, were steered so as to avoid the quicksands of speculative excess or the rocks of too rigid notions of what should constitute investment practice. When allowance is made for the fact that the financial and economic conditions of this time were monetarily infertile, the eventual successful emergence of many of the trust companies, although somewhat long delayed, indicates that the degree of directorial skill cannot have been negligible.

Errors of Policy

Whilst the foregoing remarks have been made in all fairness to the controllers of the investment trust movement, we must not altogether overlook errors of policy, among them the putting of investment trust money into one industry only and so defeating the purpose of the investment trust movement. Thus, we had several railway investment trusts, a brewery share trust, a nitrate share trust, and so forth. In the heavily quaffing Victorian days putting all one's money into brewery shares of one kind or another was a fairly safe and a decidedly respectable proceeding, although taken at the expense of the policy of spreading one's risk to the utmost. Therefore, the brewery share trust was not on ground which gave easily, but in other directions where investment trusts concentrated interests tremors were quickly felt. Declines in Home

Railway dividends, for example, gave a sharp shock to the railway investment trust companies, the Deferred Stock of one of the largest of these companies standing at nearly 75 per cent discount as an outcome. Some of the directors of the one industry trust companies early learnt the lesson and took powers to have the Articles of Association of their companies altered so that they could invest in a wide range of stocks and shares.

Over-purchasing in 1890

In 1890 occurred over-purchasing of Argentine and of South African securities; investment trusts had little if any responsibility for the latter, but the use of their surplus funds played some part in the former. The Argentine remissness of 1890, the panic in the London Money Market, and the suspension of the great merchant banking firm and issuing house of Baring Brothers, are episodes which must receive a chapter almost to themselves. We have only to note here that the crisis caused by these events brought several investment trust companies to an end, several others reduced their capital, and one of the strongest of the trusts, the Alliance, paid no dividend on its deferred capital for ten years. On the other hand, a few of the trust companies maintained their dividends through a commercial depression which was to last for six years, that is, until trade recovery began in 1896, during which time the United States, Australia, and Italy were added to the countries shaken to their financial foundations.

Publishing Investment Holdings

We find in 1889 many of the English investment trusts publishing a list of their investments, and whilst the practice has not become general among the English companies, yet if we take any year since we usually discover that

about one-third have done so. But the annual publication of a list of investments held has never been approved by the directors of the Scottish investment trust companies, whose reports with one or two exceptions to prove the rule are always silent upon this matter. Provided that implicit faith is reposed in the directors of an investment trust there might at first seem to be no special reason why the lists should be published, particularly as wrong conclusions might be drawn by investors who could not be aware of every shade of influence which brings about changes in investments held from year to year. Further, a statement of a trust's investments at the end of each of its financial years would not indicate all that had happened in between. On the other hand, there is the consideration that the directors of an investment trust are paid servants and that those who pay them should have some means of checking the competence of their employees; for even if the financial results of a company are good, conceivably the results might have been better, and, if the results are bad, they might have been worse. It has been acknowledged in a paragraph preceding that on the whole the direction of investment trust companies so far has been skilful; but it would be unwise to rely upon tradition and to assume that as the old groups of directors disappear their places will inevitably be taken by men of equal calibre. Then, too, there is the danger of the appearance of new investment trust companies, undistinguished of direction, and basking in the glory shed by the great exponents of the investment trust art. Such, indeed, has happened. The directors of this type of company may invoke precedent and plead that their personnel is sufficient guarantee and attribute any ill-success to causes beyond their control. Whilst it is pleasant to emphasize the personal side in a world which is becoming increasingly mechanized there is a danger in throwing everything upon personnel.

Some indication of this last can be seen from the great difference in the extent of depreciation which has occurred during Stock Market recessions in the market value of securities held by investment trusts. Probably, it would be in the best interests of everyone concerned if the investment trust companies published annually a full list of investments, setting forth also a complete analysis of the types of investment and the geographical distribution of them, somewhat after the style of the example below, in which the policy of the directors is clearly summarized—

CLASSIFICATION OF INVESTMENTS

PERCENTAGES

Geographical Positions	Character of Undertakings							
	Industrial	Railways	Government and Municipal	Public Utilities	Banks, Insurance, and Investment	Financial Trusts, Land, and Property	Mining	Total
Great Britain . .	25·1	1·4	—	1·1	6·3	·9	—	34·8
British Dominions, etc.	9·0	·6	·5	3·0	·9	2·3	1·7	18·0
S. America (excluding Argentine) .	3·3	2·9	4·1	·5	·7	1·3	—	12·8
Europe	2·6	·2	5·0	2·5	1·2	·2	—	11·7
U.S.A.	7·1	·7	—	1·0	·1	—	—	8·9
Argentine . . .	·1	5·4	1·2	·2	—	·6	—	7·5
Asia and Africa (excluding British Dominions, etc.) .	1·3	·3	·8	2·0	—	·3	·2	4·9
Mexico and Central America . .	—	·7	—	·7	—	—	—	1·4
Total . .	48·5	12·2	11·6	11·0	9·2	5·6	1·9	100·0

DENOMINATIONS OF SECURITIES

Bonds, Debentures, Debenture Stocks, and Notes . .	38 per cent
Preference and Preferred Ordinary Stocks and Shares .	23 ,, ,,
Ordinary and Deferred Ordinary Stocks and Shares .	39 ,, ,,
	100

The Fixed Trust

There is little to suggest that we stand in similar danger in Great Britain, but it may be remarked that the investment trust movement in the United States has suffered considerably by reason of the shortcomings of directors, and money subscribed in that country for investment trust purposes has been used in a manner the opposite of conservative. One of the results has been a reaction by investors in favour of a fixed trust, that is, a trust holding from year to year a number of specified securities, the securities being varied only under the most exceptional circumstances. Therefore, the duties of directors of fixed trusts are largely a matter of the fulfilment of routine. The fixed trust, which has been introduced into Great Britain, loses by its limitations far more than it gains. Anything which could be regarded as a reform of investment trust practice would have to be on the lines of an increase of flexibility.

A typical example of the fixed trust in Great Britain is one formed to hold ordinary shares in some two dozen British companies, the holder of the fixed trust share thus being really a shareholder in these companies. Indeed, the arrangement usually is that the fixed trust issues a certificate to its shareholders indicating that the trust holds so many shares of one kind or another on behalf of the shareholder in the trust, the number of shares varying according to the amount invested in the trust by the individual. Such a trust can only be successful if it so happens that a majority of the shares it purchases are moderately valued, but inasmuch as the trust is continually making purchases, according as it receives applications for its own shares, the basic principle of the trust involves the assumption that the value of the shares purchased will progressively increase whatever the prices the trust has paid for them. We all know that accidents happen in

the best regulated families; there is no industry which is immune from severe setbacks. The ability to anticipate changes in prosperity well before they come and to vary investments presciently is the life-blood of the investment trust.

It has been contended that the fixed trust is not really a trust at all but a "merchandising proposition, pure and simple." Possibly, the contention is accurate, for as we have seen in the example given above, the fixed trust really sells shares in other companies and holds the shares of those companies on behalf of a purchaser of the trust's own shares. A point to be noted in favour of the ordinary type of investment trust companies is that there is an established financial procedure common to them all, varying in the degree of success with which it can be observed, but having always a conservative tendency in the matter of the accumulation of reserves. It should be mentioned also that an investment trust company includes as revenue only the dividends received from its holdings during the trust company's own financial year, and that profits made by the sale of investments are not included as revenue, being re-invested and the profits on the re-investments credited in due course to revenue account. The discrimination has no special implications over a long period for the holder of investment trust shares, because the profits of the company, whether on revenue or capital account, come to him eventually, either by way of increased dividends, bonuses, or the capitalization of reserves.

The main features of the ordinary type of investment trust were fully developed in the period from 1871 to 1895, and therefore we shall have no cause to recur to the subject when dealing with subsequent years. Our reference to the fixed trust represents one of those leapings forward out of the strict bondage of period, a departure which readers were warned would be inescapable as we neared

the twentieth century; for the fixed trust was introduced to Great Britain in 1931. The departure made, we may record that a year later the ordinary kind of investment trusts—both English and Scottish—formed a common organization for the protection and advancement of their interests, some £300 millions of capital being represented in the organization. Such an organization clearly has great power to secure by collective effort the fair treatment of investors by states and companies, and since subscriptions by investment trust companies contribute substantially to the success of new issues of capital, Governmental or otherwise, the organization has monitory powers in this direction also.

CHAPTER XIII

LATER VICTORIAN YEARS: MAINLY OF SINKING FUNDS AND CONVERSION SCHEMES

THREEPENNY Income Tax—Halcyon days and minor strains—A new Sinking Fund—Sir Stafford Northcote helps himself—Treasury Bills—A sign of inflation—The chilling of Mr. Childers—Mr. Goschen's Conversion Scheme—His three main things—The measure of success—A common defect

TURNING now to a consideration of the national finances in Great Britain during the period under review, the key-note may perhaps be found in the fact that the Income Tax in 1873 was 3d. in the £, or a 1d. less than in 1866. In the interval between these years the Income Tax had been as high as 6d. in the £. Proverbially, neither men nor nations know when they are well off, and it might have been thought from the amount of agitation in some quarters that a 6d. Income Tax foreshadowed the approaching end of the world. Indeed, even a 3d. Income Tax was alleged to be unendurable, and Mr. Gladstone in his Election Programme of 1874 suggested the abolition of the tax altogether. However, Mr. Gladstone was not returned to power on that occasion. The Income Tax remained; by twenty years later, that is, in 1894, it had risen to 8d. in the £.

Whatever may have been thought at the time, those were really halcyon days, as far as the nation's debt and taxes were concerned, and whereas most countries, with more or less justification, were adding to their obligations Great Britain substantially reduced her commitments. Thus, the National Debt at the end of 1872 was £790 millions, and by the end of 1895 just under £656 millions. Admittedly, agricultural and trade depression was in evidence from 1876 to 1880; and in 1877 apprehensions of a

war with Russia over the Near Eastern question caused alarm; in 1881 came the military disaster at Majuba, followed by that of Khartoum in 1885. But these were minor strains compared with what the nation had withstood before and was to endure thereafter. Sir William Harcourt may have been premature by only a few years when he described economy in national expenditure as "a lost art," but there was not much of which to complain in the years which were the occasion of his misgiving. It is true that the national expenditure for 1895 was £15 millions higher than for the year a quarter of a century previously; but in the meantime the population had increased by 8½ millions.

A New Sinking Fund

The attempt to reduce the National Debt began early, Sir Stafford Northcote, the then Chancellor of the Exchequer, proposing in 1875 a new form of Sinking Fund. Since 1829 there had been in operation the Sinking Fund that had replaced Pitt's wild redemptive scheme. The 1829 Sinking Fund plan, we may recall, merely provided that a surplus of revenue in any year should be placed to the credit of a Fund for the redemption of the National Debt by purchase and cancellation of Stock or by other means. Actually, between 1829 and 1875 some £50 millions of National Debt had been reduced, largely by means of the Fund, or at the rate of somewhat over £1 million a year. This was not rapid progress. But in the nature of things little more could be accomplished under the existing arrangements, unless Chancellors sought not to balance their Budgets, but by means of taxation to secure substantial surpluses in order to devote them to the Sinking Fund. What the Sinking Fund had received during forty-six years had been mostly very small allocations when the Chancellors found themselves on the right side; it need

hardly be added that this comforting position was not invariably reached. Sir Stafford Northcote proposed to modify the yearly estimates so that a fixed sum would be available for Sinking Fund purposes, and also to retain the old Sinking Fund, the arrangements of which decreed that any surplus that happened to be realized in any year would be devoted to the redemption of the National Debt.

Sir Stafford Northcote Helps Himself

The New Sinking Fund was not to come into operation until 1878; in that year there was a Budget deficit of £2,640,000, in the following year one of £2,292,000, and for 1880 the deficit rose to £2,841,000. The outcome was that during these three years neither the Old nor the New Sinking Fund was anything more than a name; the Chancellor increased the National Debt by borrowing and, finally, in order to balance his Budget helped himself to some of the money accumulated in the Sinking Fund. From that day forward the Sinking Fund has been farcical; indeed, such an element was never entirely absent from its composition before the days of Sir Stafford Northcote and probably never will be. Ridiculously small in relation to the volume of the National Debt, the Sinking Fund is subjected to "raids" from time to time by Chancellors of the Exchequer, upon whose misappropriations the stamp of righteousness can always be ingeniously placed.

The Introduction of Treasury Bills

Sir Stafford Northcote's claim to be remembered by succeeding generations rests rather upon his introduction in 1877 of the system of Government borrowing for short periods by means of Treasury Bills. Hitherto, short term borrowing by the Government had been by means of Exchequer Bills, the origin of which we discussed in Chapter V. Exchequer Bills, as they existed immediately

before 1877, enabled the Government to borrow for terms of twelve months or longer, but for no lesser period. Frequently, however, the needs of the Government would have been met by borrowing for shorter periods had the machinery been to hand, and by doing so Government finance would have benefited from a lower rate of interest. Therefore, Treasury Bills were created to run for three, six, or twelve months; these Bills bear no specified rate of interest, but are tendered for at a discount, the Government accepting the tenders which, on the average, work out most favourable to itself. But whilst no interest as such is payable it is easy to see that if the Government accepts, let us say, tenders at an average of £99 5s. for Treasury Bills repayable at £100 in three months' time, the Government is really paying slightly over 3 per cent per annum for the convenience; similarly, with Treasury Bills for longer periods.

A Sign of Inflation

Treasury Bills rapidly became established as the predominant short term security, and the old system of issuing Exchequer Bills was eventually discarded. Treasury Bills are primarily investments for banks and discount houses, tenders for less than £5,000 worth not being considered. If we were to discuss fully the part which Treasury Bills play in the national economy we should have to enter into Government Finance and general banking practice to an extent not justified by our theme. But we may remark that whether or no the Government of the day is pursuing an inflationary policy is indicated by, among other signs, the amount of Treasury Bills in existence. No clearer instance of this is likely to be afforded than is provided by the years of the Great European War from 1914 to 1918. The amount of Treasury Bills in existence at the end of 1914 was £99 millions, from which they

rose to slightly over £1,100 millions at the end of 1919—the year after the termination of hostilities. This more than ten-fold increase of Treasury Bills reflects unparalleled, stupendous inflation. The figures for the next decade reveal the Government's policy of deflation, the amount of Treasury Bills in existence at 31st March, 1928, being £527 millions, rising to £955 millions by November, 1933 as a result of a phenomenal happening which will be described in the due place. Broadly speaking, deflation implies the restriction of credit, inflation the expansion of credit, courses which have a direct bearing upon the trend of security values one way or the other, and of the possibilities of which the investor who wishes to safeguard himself should be aware. We must leave this matter for the time being and take our way back to 1884, when nearly all of the Government Debt then in existence could either be repaid at par without notice or on giving notice of one year.

The Chilling of Mr. Childers—1884

In this year the tendency for interest rates to fall was already marked, and the Chancellor of the Exchequer, Mr. Childers, offered to holders of the Government Stocks which might be cancelled by the payment of cash new securities bearing a lower rate of interest but which would be practically of an irredeemable nature. The proposal was cold-shouldered by the banks, and this would-be Conversion Scheme has to be set down as a complete failure. Under these circumstances there would be little point in discussing what Mr. Childers had in mind, particularly as where he failed, another was four years later to achieve overwhelming success. That other was Mr. Goschen, who besides being a skilful politician was also a financier of outstanding ability. Additionally, the fates were kind to Mr. Goschen; in four years financial temper

had so changed that there was haste to convert where there formerly was refusal to do so, and the attitude of the banks had altered to such an extent that they were all in favour of accepting less generous terms than those which Mr. Childers had offered and on which they had frowned.

Mr. Goschen's Conversion Scheme—1888

It will perhaps conduce to clarity if we tabulate the kinds of Government Stocks with which Mr. Goschen dealt; accordingly the details are set out below—

Amount and Description	Government's Right of Repayment	General Remarks
I. £69,000,000 Reduced 3%	At par, on giving one year's notice.	This Stock was created under Mr. Pelham's Conversion Scheme of 1750.
II. £323,000,000 Consd. 3%	Ditto.	As the title conveys, originally a consolidation of various 3 per cent Annuities. The consolidation of the Annuities took place in 1752, but further issues of the Stock were subsequently made.
III. £166,000,000 New 3%	At par, without giving notice.	This Stock was created under Mr. Goulburn's Conversion Scheme of 1844.
IV. £34,000,000	—	Represents various Annuities which the Government had power to terminate; for the purposes of Mr. Goschen's Conversion Scheme these Annuities were regarded as ordinary Government Stock.
£592,000,000	Total Amount dealt with by the Conversion Scheme of 1888.	

His Three Main Things

Mr. Goschen remarked when introducing his Scheme that he had learnt three main things from the history of past Conversions. "The first is that it is advisable to avoid nominal additions to capital, as it may cause eventual loss to the Government, and it would be likely to prevent the success of the Bill in Parliament. Secondly, to avoid complicated options and not to give people a large number of things to decide upon, because they will not understand them, and if they do they will never make up their minds, but give them one thing only and they will take it. The third is, that guarantees against redemptions or further reduction in the interest for fixed periods have generally been appreciated and give stability, something upon which people can rely." The second of Mr. Goschen's observations, at least in so far as it refers to offering people one thing and they will take it, is clearly an estimate of human nature which might form the basis of many forms of activity wherein it is sought to persuade masses of men and women. It cannot be said that avoidance of nominal additions to the amount of Government Stock in issue has been the anxious concern of every Chancellor since Mr. Goschen; indeed, several of his successors have claimed that as long as the yearly interest charge of the National Debt is reduced, increases of the amount of the Debt are unimportant. If an addition to the National Debt is of an irredeemable nature, and if also, by reason of monetary or other conditions, the interest weight of the whole debt is unchanged or lower, then the claim to which we have referred is not without justification, and there is no possibility of eventual loss to the Government. With regard to Mr. Goschen's third point, while guarantees against further reductions of interest may rightly be appreciated provided the interest guaranteed is adequate, a guarantee against redemption is by no means in all cases an unmixed

blessing. It has to be noted that a stock which bears a low interest and which has no guarantee of redemption at a fixed price within a period specified stands always in danger of the emergence of fresh stocks bearing a higher rate of interest and having an equal status. Actually, the Conversion Loan which Mr. Goschen issued was not irredeemable; but it could not be redeemed until thirty-five years after the date of issue when, as it happened, conditions proved to be such that redemption was out of the question.

The Measure of Success

Mr. Goschen offered to holders of all of the securities mentioned in the table on page 137 a Stock which was to bear interest at 3 per cent until April, 1889, 2¾ per cent from April, 1889, to April, 1903, and 2½ per cent from April, 1903, to April, 1923, and since no Government in 1923 or after had used its option to redeem, in 1933 Mr. Goschen's Consols were still bearing interest at 2½ per cent. All who surrendered their Old Stock speedily and accepted the New were granted a small bonus, and stockbrokers, bankers, and others who lodged assents on behalf of their clients before a certain date received a commission. So successful was the Scheme that holders of only £11¾ millions of the total of £592 millions of Stock involved demanded payment of cash. The cost of the Conversion Scheme in bonuses, commissions, extra dividends, and remuneration to the Banks of England and Ireland was £3,010,000; the immediate saving in interest on the National Debt was £1½ millions per annum; a further £1½ millions per annum was to be saved when the interest on the Conversion Stock was reduced from 2¾ per cent to 2½ per cent.

A Common Defect

So trusting was the mood of the time that the Conversion Scheme swiftly caused advances in the prices of all

British Government Stocks and, to quote a newspaper of that day, "it almost seemed as if a reduction in the rate of interest was regarded by members of the Stock Exchange as a boon to Fundholders, for which they can be duly thankful, and which would add to the market value of their property." Nor was such a regard, however irrational fundamentally, soon to be made to appear foolish; for in 1895 each £100 of Conversion Loan, that is, Stock the interest on which had been reduced from 3 per cent to 2¾ per cent, reached a price of £114 on the London Stock Exchange. Then was the time for wise people to have sold, more especially as in only a few years the interest on the stock was to be reduced by ¼ per cent. Possibly wise people did so; by 1914 the price of the then 2½ per cent Consols had fallen to 70 and some banks were still busy writing off depreciation on their holdings acquired thirty years before. We have no evidence whether they were still doing so in 1920 when the price fell to 40. Conversion has much to be said for it; but both the religious and the financial kind have the defect in common that they tend to take from men an extremely useful element of scepticism, or more correctly, the capacity for pessimistic forethought.

CHAPTER XIV

TRUSTEE INVESTMENTS—1889 TO 1933

TRUSTEE Investments—The 1889 turning point—The Acts of 1893 and 1925—Colonial Stocks—Parliamentary guarantees—Some restrictions—The 1925 Committee—Untoward developments—The necessity of critical judgment—Possibly a stronger case

THE subject with which we have next to deal is that of Trustee Investments, of Stocks and Shares in which it is legally permissible for Trustees to invest funds which come under their control. It must be said at the outset that often the terms of the Trust contain restrictive clauses with regard to the type of security the Trustee is allowed to purchase, when from one reason or another he wishes to make an alteration in the disposal of the funds he administers on behalf of the beneficiaries of a will or other settlement. But where no such clauses exist, the investment powers of the Trustee are determined by the State. The turning point in the attitude of the State toward Trustee Investments occurred in 1889; until then the position was extremely simple, the Trustee being only allowed to invest in 3 per cent Government Stock any money which became free under his Trust. No choice whatever was given him. In the year 1889, however, there was passed the Trust Funds Investment Bill, which enlarged the area of investments for the Trustee. The Bill did not include the stocks of Colonial Governments; by far the most important of the new securities in which Trustees were given the option of investing were the Preferred Stocks of all British railway companies that had paid a dividend of not less than 3 per cent on their Ordinary Stocks during the two years prior to the date of the investment. The emphasis upon the status of railway stocks, subsequently repeated but with greater reserve,

caused many solicitors and others acting as Trustees to invest heavily in this type of security during the next two decades. Some of the minors for whom they acted were to have cause in later life to regret this exaltation of railway stocks; but so also were some to deplore the downward rush of the price of Government Consolidated Stock, which no less an authority than Mr. Gladstone had proudly declared to be "the most intelligent thing inanimate."

The Acts of 1893 and 1925

It was soon felt that the additional powers given to Trustees by the 1889 Bill were not nearly sufficient, and so the Bill was followed in 1893 by the Trustee Act, giving to Trustees a much wider range of stocks from which to select. Henceforward, Trustee Securities included the stocks generally of the British Government, stock of the Bank of England, the Bank of Ireland, those of the Metropolitan Board of Works, the London County Council, English water supply companies, of the Corporation of any municipal borough having a population exceeding fifty thousand, of any County Council, and certain issues of the Indian Government and Indian Railways. It is noteworthy that the stipulation with regard to Home Railway stocks was strengthened, the new requirement being that the Company should have paid a dividend of not less than 3 per cent per annum on the Ordinary Stock for *ten* years past. Additionally, Trustees were allowed to invest "in any of the Stocks, Funds, or Securities for the time being authorized for the investment of cash under the control or subject to the order of the High Court." Some of the Stocks added by this last were duplications of those authorized under other clauses of the Trustee Act; but all of the Stocks allowable, whether by Act of Parliament or Rule of Court, were subject to the provision that the Stocks must not be redeemable within fifteen

years from the date of purchase. The most important of the Securities coming under the High Court Rule at that time were Local Loans Stock, created under the National Debt and Local Loans Act of 1887. It is unnecessary for us to trace the history of these Local Loans; they represent expenditures formerly raised out of the rates and now met by Government-sanctioned borrowing on the part of the local authorities. Although certain Indian Stocks were included in the 1893 Act, no provision was made for the stocks of Colonial Governments. The omission was rectified by the Colonial Stock Act of 1900, which gave power to Trustees to invest in a number of Colonial Stocks registered in England.

The Colonial Stock Act remains in force at the time of writing, that is, 1933, but the Trustee Act of 1893 was succeeded by the Trustee Act, 1925. This Act, which, like its predecessor, did not apply to Scotland, does not vary in essential requirements from the earlier legislation. It will be sufficient for our purpose, as far as reference to differences in Scottish law is concerned, to state that there are certain securities available for trustees in England which are not available for trustees in Scotland; and *vice versa*.

The Acts Further Considered

The adding of over £7,000 millions to the British National Debt between 1913 and 1920 enormously increased the field of Trustee Investments. The first provision of the 1925 Act is identical with that of the 1893 Act, namely, that a trustee may invest any trust funds in his hands "in any of the Parliamentary Stocks or Public Funds or Government Securities of the United Kingdom." But it must be observed that the United Kingdom does not now, as it did in 1893, include Southern Ireland, which in the interval had become a "Free State"; neither in 1933 are the stocks of the Southern Irish Government

accorded trustee status under the Colonial Stock Act, as are the stocks of the Union of South Africa. Indeed, no Southern Irish security has trustee status with the exception of Irish Free State Land Bonds, the interest on which is guaranteed by the British Parliament, while Bank of Ireland Stock has been retained as a trustee security, being regarded as an Irish rather than a Southern Irish Stock, and independent of changes of Government in one part of the Emerald Isle. Bank of England Stock remains in the 1925 Act, and passing over "the real or heritable securities" we come to Indian Government Stocks, the clause concerning which we had better set out in the exact wording. Trustee status is given to "India Seven, Five-and-a-half, Four-and-a-half, Three-and-a-half, Three, and Two-and-a-half per Cent Stock, or in any other Capital Stock which may at any time be issued by the Secretary of State in Council of India under the authority of any Act of Parliament, and charged on the revenues of India, or any other securities, the interest in sterling whereon is payable out of and charged on the revenues of India."

Parliamentary Guarantees

The next provision is that the Trustee may invest in any securities on which the interest is for the time being guaranteed by Parliament. The number of securities coming within this class is small, in 1933 numbering thirty-three. Twelve of the securities were on behalf of Colonies, Dominions, or Protectorates, one for a foreign Government, six for Home Shipping or Railway Companies, six for Home Industrial or Power Companies, and the remaining eight for miscellaneous enterprises. Immediately after the War of 1914–1918, the idea of Parliament guaranteeing miscellaneous securities gained in popular favour, but a reversal of public opinion soon occurred. The references in the 1925 Act to County Council, Water

Board, Water Supply Companies, Railways, and Indian Railways do not call for special comment. The Trustee Act can be made the subject of retrospective amendment, as, for example, when it is wished to include an investment which would otherwise not be covered. Such was the case with the Agricultural Credits Act of 1928, which authorized investment in the debenture stock of the Agricultural Mortgage Corporation, formed under Government auspices to assist in the provision of credit for agriculture. The Housing Acts of 1919 and 1925 also legislatively added to Trustee Stocks.

Restrictions on Purchases

A restriction applicable to certain Trustee Stocks is that where a stock is redeemable within fifteen years of the date of purchase it must not be purchased at a price exceeding its redemption value, and if redeemable at a more distant date at a price not exceeding 15 per cent over par, or the fixed amount at redemption. It would be well for the private trustee to consult a solicitor or stockbroker with regard to this clause and others. The Trustees Act is couched in pure Parliamentary language, but it has hardly the undeviating limpidity of *The Pilgrim's Progress*. It may be explained, however, that the price of a stock is not necessarily above par in the legal sense if it happens to be above 100. For example, a stock may be quoted at 102 but be entitled to a dividend of 2½ per cent, or at the rate of 5 per cent per annum, for the six months preceding the time when the stock is bought. Under such circumstances, the price of the stock is that which remains after deduction of the allowance for dividend; in the example cited the net price would be 99½.

The 1925 Government Committee

The provisions of the Trustee Act are from time to time subjected to criticism by those interested in money affairs;

in deference to criticism a special Government Committee was appointed in 1925 to review the position with regard to Trustee Securities. The principal conclusions of the Committee were that the range of Trustee Securities should not be enlarged, and that the Securities should receive their status in future directly by public general statute, and not partly by local and private Acts. It is evident, in view of the large additions to British Government Debt as a result of the European War, that the argument that Trustee Securities should be increased because of an existing scarcity was not one which could be substantiated. The Committee rightly remarked that to make considerable additions to Trustee Securities might reduce the value of the Trustee Securities already in existence. The fact that the Supreme Court had power to increase Trustee Securities theoretically removed from the complete control of Parliament the rate of increase in the Trustee type of security. Actually, no such danger had arisen from the Court's power, which had been sparingly used. Nevertheless, the Committee's recommendation that the authorized range of Trustee investment should in future depend directly and solely upon statute was a sensible suggestion of unification.

Untoward Developments: Home Railways and Australia

The recommendations of the Committee with regard to placing Trustee Investments under a single statutory control were not immediately acted upon, but the Government endorsed the Committee's opinion that additions to the categories of Trustee Investments were unnecessary and undesirable. Not all of the critics were satisfied with the decisions of the Committee, and as it happened the hands of the doubters were strengthened by developments

in connection with two classes of Trustee Securities—British Railway Stocks and those of Australian States and the Australian Commonwealth. In 1931 the London & North Eastern Railway failed to pay full interest on a junior preference stock, and the whole of its fixed interest securities lapsed from trustee status; but although the Southern and Metropolitan Railway Companies failed to pay the prescribed 3 per cent on their Ordinary Stocks the prior stocks of these companies were retained in England as Trustee Investments, but not in Scotland in the case of the Southern. It stood revealed that the endeavour to retain certain British Railway Stocks as Trustee Investments was putting a severe strain on the original conception of the Trustee Act, and especially was it remarked that the London, Midland & Scottish 4 per cent Preference Stock was being retained as a Trustee Investment, although the dividend had not been actually earned. It is not surprising that extraordinary facilities were given whereby Home Railway Stocks might retain their Trustee position. Railways were for long one of the most cherished material possessions of the British Isles, and their stocks held by tens of thousands of investors, many of humble means. If it had been possible in 1893 to foresee the effect upon the railways of road competition, then the inclusion of Railway Stocks as Trustee Investments might have been more cautiously undertaken. The relating of trustee status to the payment of Ordinary dividends seems to deserve disapproval under any circumstances; for the maintaining of Ordinary dividends in order to retain that status might lead to payment in dividends of moneys which should be placed to Reserve.

Trustees and the Critical Faculty

So far as Australian Government Stocks are concerned it is possible that the indiscriminate granting of trustee

status to them may have led to excessive borrowing on the part of this Dominion; for the Trustee Stocks of the Australian Commonwealth and States were in 1933 seven times the amount of the Trustee Stocks of Canada. The temporary defaults of Australia produced the admission that the British Treasury had no control over Dominion borrowers and that, excepting by means of special legislation, a Colonial Stock cannot be removed from the Trustee List even though its interest is not paid. It must be commented, however, as far as Australian financial excesses are concerned, that it is unreasonable to argue that because a stock is classified as a Trustee Security, trustees are not to exercise their critical faculties, or, at any rate not to seek the aid of the critical faculties of investment experts. Trustee Securities which were also Australian Government Stocks were for years eschewed not only by trustees but by many investment trust and insurance companies.

So, too, with Home Corporation Stocks. It is true that granting of trustee status to the stocks of corporations with a population of 50,000 or over seems to be a rather loose procedure in the absence of some additional safeguard more precise than contained in the Municipal Corporation Act of 1834, passed half a century before the extension of Trustee Securities. But here also the trustee must exercise his own or make use of other people's judgment. He should be aware that the standing of one British corporation is not inevitably as good as that of another, although as a matter of fact untoward events have hardly ever proved the contrary. It should be noted, too, that the tendency is for private judgment to be usurped by collective judgment embodying wider experience; trusteeships pass more and more into the hands of the Public Trustee, banks, and insurance companies; the Public Trustee alone having responsibility in 1933 for over 28,000 trusteeships of a total value of nearly £314 millions.

Possibly a Stronger Case . . .

Possibly, in spite of the large number of Trustee Investments already available, there is a stronger case for widening the field of Trustee Securities than was conceded by the 1925 Committee; yet clearly the error of too rigid exclusion is much to be preferred to the one of too generous inclusion. It has been said responsibly that it is anomalous to exclude building society shares from trustee status, as it is to exclude securities of the soundest industrial concerns. But building societies have their ups and downs and their periodical crises, and they may vary their rate of interest at any time. We might give the building societies' securities an honour in fair weather which we should regret having given in foul. With regard to industrial companies, well, there was a commercial crisis in 1929 and for several years afterwards which might give us pause on this point. By the test of ability to meet obligations in all the changing scenes of life, we should have to bestow the trustee accolade on the stalwart shares of catering, coal merchanting, and retail chemist companies. It would be making an enticing distinction for the sake of a dubitable gain.

CHAPTER XV

THE FINANCIAL CRISES OF 1890 AND 1893

COMMERCIAL and financial crises—The happenings of 1890 and 1893—Excessive capital issues—The South American shadow—Argentine flotations—Running up land values—Issuing houses—The commitments of Baring Brothers—The storm breaks—Concerted action by the banks—A guarantee fund—A sharp distinction—The 1893 agreement—And the 1896 non-fulfilment—Running and reading—Trouble in Australia

COMMERCIAL and financial crises recur with such apparent regularity that some persons have ascribed the phenomena to the operation of divine ordinance, and have claimed that the celebrated dream of Joseph contains a lesson applicable to all history and to all that will become history. Others of a different turn of mind have related sun-spots to business depression and have alleged that the appearance of the former is swiftly and inevitably followed by the development of the latter. Mundanely disposed persons such as ourselves, however, travel a matter-of-fact road, and for us the occurrence of widespread business inactivity is mainly the result of imperfect knowledge of the laws of sensible living or the breaking of those laws which are fully perceived, but which it is inconvenient to observe. The consequences of these limitations of vision or deficiencies of conduct become more serious as the world grows complex, as capital flows from one nation to another, and as trade between the nations nets itself so as to be inextricable, save by violent dissociation.

So far, although a reference to acute commercial depression occurs early in this book no single chapter has been devoted to that subject or to the allied one of a financial crisis. Naturally, prolonged commercial depression produces financial difficulties both for Governments and for individuals; we shall have more to say upon this when

we are nearing the end of our inquiry. But financial strain can proceed from a purely financial origin; it is with two expressions of this type of crisis that the pages immediately ensuing are concerned. They are, perhaps, not major crises, although at least one was declared to be so at the time, and the moral to be drawn from them is not solely an investment one. Nevertheless, both crises produced a sharp fall in the quotations of Stock Exchange Securities, and, since the well-armed investor is he who can gauge the approach of falls as well as of rises, we must see if we can make one or two lessons plain to him from the happenings of 1890 and 1893.

THE SOUTH AMERICAN SHADOW

It was evident in 1888 to anyone who cared to look at the facts that trouble was brewing; in that year £160 millions of new capital issues were made in London, followed in 1889 by new issues to the extent of £190 millions. The power of the Home Market to absorb new offers of capital had been competently estimated at that time as from £100 to £120 millions per year; therefore, it must have been the case that large amounts of the new capital placed in 1888 and 1889 had passed into the hands of persons who would have to get rid of their holdings at no distant date; some of these persons were only waiting the first opportunity to snatch premiums on their shares when the Stock Markets were burnished into sufficient glamour to trap the unsuspecting. Capital chiefly flowed during these two years into various South American shares, home brewery shares, and the shares of mining companies, principally those engaged in North America and Africa. The sum subscribed for mining ventures in 1888 was £52½ millions, and in 1889 £41 millions, figures which show that the speculative spirit was riding high. That the authorities were well aware of the dangers which

threatened is plain from the fact that the Bank Rate at the opening of 1890 was 6 per cent, to which it had been raised in the November preceding, comparing with an average of just over 3½ per cent for the whole of 1889.

Possibly, the dearness of money diminished the speculative fever in Britain; but in January, 1890, the shadow thrown from a conviction that South America and especially Argentina had over-borrowed began to deepen over the Stock Exchange. Then, too, Brazil had had a revolution a few months before and was now in the throes of riotous finance, a state of affairs which naturally increased the feeling of nervousness in London.

Argentine Flotations

Argentina had been growing in British estimation for nearly a decade, ever since she abolished internal customs dues between her various constituent States and had accomplished some measure of practical federation. General Roca, the then President of the Republic had in 1880 made Buenos Aires the chief place of revenue collection, the revenues there collected being apportioned to the needs of the Republic as a whole. The step was one which knit the States more closely together and enhanced the power of the National—that is of the Central—Government of Argentina. But the Provincial Governments were still left with extensive financial powers, and we find in 1890 that not only had the National Government contracted loans, fourteen Provincial Governments had also borrowed internally and externally and had printed a vast amount of paper money, the backing of which was less than hypothetical.

In 1880 Argentine securities to the face value of £40 millions had been floated in Great Britain and other European countries, an amount which has to be related to Argentina's total population, at that time between four

and five millions. Emphasis was put, however, not upon population, but upon the 1,153,000 square miles of Argentine territory and upon all the hopeful possibilities of a young country, potentially a rich agricultural producer. As far as Argentina's external debt was concerned, the amount at the beginning of 1890 was about £22 millions, a figure which does not lend itself to pronouncedly adverse criticism; with regard to domestic finance, a very different story has to be told. In 2½ years approximately £38 millions had been advanced on mortgages on land, these mortgages, or *cedulas*, as they were called, being issued with the approval of the National and the Provincial Governments. The result of assigning a fictitious value to land and making liberal loans on the basis of the fictitious value was the continuous issue of paper money and a general condition of inflation bringing about rampageous rises in prices of commodities.

The London Issuing Houses

It is desirable, in order that the subsequent turn of events in London may be the better appreciated, to set out at this stage particulars of issues of Argentine securities of amounts of £1,000,000 and over, handled by London firms in the eighteen months to the end of 1889. The details are set out in the table on page 154.

The Commitments of Baring Brothers

The word "handled" was used in the introductory sentence relating to the table because the £5,000,000 Loan on behalf of the Buenos Aires Water Supply and Drainage was not successfully launched; the failure betokened the imminence of storm. It will be noticed that the firm of Baring Brothers was specially involved in Argentina; indeed, much more heavily than appears from the calculated figures of issues, because as merchant bankers the

ARGENTINE ISSUES OF OVER £1,000,000. MID-JUNE, 1888–END 1890

Description	Amount	London Issuing House
	£	
Argentine Government 4½% Loan	3,442,000	Baring Brothers
Buenos Aires Water Supply and Drainage	5,000,000	,, ,,
Buenos Aires Western Railway	2,500,000	,, ,,
Ditto 4% Debentures .	1,000,000	,, ,,
City of Buenos Aires 4½% Loan	1,716,000	,, ,,
Argentine Northern Central Railway 5% Bonds . . .	1,133,000	C. de Murrieta and Co.
Province of Entre Rios 6% Loan	1,164,000	,, ,,
Cordoba Central Railway. .	2,342,000	,, ,,
Argentina North Eastern Railway	1,020,000	Antony Gibbs & Son
City of Buenos Aires 6% Loan	1,306,000	L. Cohen
City of Rosario 6% Loan .	1,021,000	Heinemann

firm carried on an extensive discounting of bills in connection with Argentine trade. As the issuing house most conversant with the actual state of affairs in Argentina, Baring Brothers were subjected to much criticism from conservative quarters in the City, it being alleged that the best service Barings could have rendered both to the British public and the Argentine Government was to have refused to attempt to float Argentine issues until the Argentine Government had at least shown some appreciation of the realities of the situation. This may have been counsel of perfection; but certainly what happened afterwards added to the City's esteem of the critics. Not many months of 1890 had elapsed before it was evident that the Argentine Government could not meet its guarantees on external railway and other loans, prices of Argentine securities tumbled violently in London, and in Argentina itself the officially instigated gamble in land collapsed.

It soon became known that Baring Brothers were in difficulties, with total liabilities of £30¼ millions, but with assets which, if they could but be realized, were

estimated to have a value of £33¼ millions, the surplus over liabilities being thus £3 millions. The main source of danger was in the acceptances of Baring Brothers, which amounted to £15¾ millions; in order to deal with these the Bank of England initiated concerted action by the great banks generally, and a guarantee was provided, the sum actually covered by this Fund amounting to £17 millions.

Baring Brothers and Overend, Gurney—A Sharp Distinction

The guarantee, at first for the full and then for a reduced amount, was continued until January, 1895, when the guarantors were released. Before the crisis in connection with Baring Brothers actually came to a head, the Bank of England had strengthened its gold reserve by £4½ millions, of which £1½ millions had been obtained by the sale to the Russian Government of Treasury Bonds held by the Bank; the other £3 millions represented a gold loan from the Bank of France for three months at 3 per cent, with the option of renewal for a further limited term. Renewal was not required and the gold was shipped back to France.

The Baring crisis had been termed a "rich man's crisis," and so in a sense it was; for it appeared that the principal difficulty, apart from the question of meeting Barings' acceptances, was that many underwriting and similar institutions had large amounts of securities in their possession which they were unable to sell to the public at a profit or even at cost price.

That the confidence of Baring Brothers in Argentina was not altogether misplaced is shown by the recuperation within a few years of both Baring Brothers and Argentina. Certainly a sharp distinction must be drawn between the Overend, Gurney crisis of 1866 and the Baring crisis of

1890. Baring Brothers committed errors of financial policy; the directors of Overend, Gurney had to thank the notions of justice prevailing in the 'sixties that they escaped the savage sentences which were then meted out to humble persons, whose financial misdemeanours were slight.

The 1893 Agreement—and the 1896 Non-fulfilment

The story of the Argentine financial excesses would not be complete without some reference to what happened to the holders of Argentine securities. In 1893 a committee of English creditors under the Chairmanship of Lord Rothschild made the offer of a three years' moratorium to the Argentine Government, subject to certain conditions, the most important of which was that a specified amount of the paper money then in existence should be retired each year. Interest payments on the Debt were to be resumed at the end of the three years. The Argentine Government accepted the proposals with alacrity, as it might well do, the Government being in an awkward corner and the offer of the Rothschild Committee a reasonable one. Nevertheless, while the Argentine Government gladly accepted the period of grace, it did not retire the paper money as agreed, and neither was it willing at the end of three years to pay the full rate of interest on its loans, proposing instead a permanent reduction of the rate. This being so, the Report of the Corporation of Foreign Bondholders for 1896 included among the loans then in default the subjoined melancholy items—

Argentina	Principal Outstanding	Interest Arrears
	£	£
Provincial Loans	20,301,000	5,682,000
Municipal Loans	2,452,000	743,000
Provincial "Cedulas" . . .	13,697,000	2,330,000

Eventually a fresh arrangement was made to the glory of the Argentine Government and the discomfiture of the English bondholders.

It is said that he who runs may read; certainly those who ran after Argentine securities in the early 'nineties had something over which to ponder. There have been honourable exceptions; usually, however, the lender who hopes that an agreement made by a defaulting country to recompense him at a future date will be carried out strictly in accordance with the original terms is like unto the lover, and insufficiently allows for the cooling effects of Time.

Banking Troubles in Australia

Only two years passed after the coming to a head of the Argentine crisis when financial trouble developed in another young country; in 1893 thirteen Australian banks suspended payment with total liabilities of £104 millions, or about half the total liabilities of all the Australasian banks.

It was estimated that over £40 millions of the deposits affected represented British money which had flowed to Australia in response to the tempting baits of high interest. So anxious were the banks to obtain deposits that in some cases commissions had been paid to secure them. The banks were confident that they could pay a high rate of interest and yet re-lend profitably. But to base rates of interest for banking loans on the potential riches of a young country is to under-estimate the difficulties which usually attend development, and unintentionally to capitalize disappointments and delays.

CHAPTER XVI

WE END OUR SURVEY OF THE 1871–1895 PERIOD

An event of 1878—Currency developments—The monetary genius of Britain—The Gold Standard—In a minor key—The railway array—Dull directors and dishonest—Shareholders' pride—Walter Bagehot's inquiry—John Stuart Mill on the export of capital—An inkling—Further reflections on the flow of capital—Giffen's estimate—Overseas securities in 1893—Christmas, 1895

Lest some one should otherwise kindly inform us that Professor Bell and Colonel Reynolds demonstrated the possibilities of the telephone to Queen Victoria on 14th January, 1878, we hasten to assure him that we are well aware that this happened. Admittedly, the use of the telephone has had an enormous influence upon investment and more upon speculation; but so, for that matter, has it had upon many other things connected with the "daily round, the common task," which, according to the revised version of an originally dreary couplet "ne'er furnish all we need to ask." In other words, it would be impossible to touch upon all of the events and foreshadowing of events which, in one way or another, have a relation to the uses to which men put their money. Nevertheless, before we end our survey of the 1871–1895 period with a little philosophizing we may make the picture more agreeable to the eyes of those who abhor sackcloth simplicity, for whom enough is by no means as good as a feast.

Currency Developments: the British Monetary Genius

Taking currency developments first, we may record that in 1871 Germany relegated silver to a subsidiary position and accepted a gold standard, a course which was followed in 1872 by Sweden, Norway, and Denmark, and between 1872 and 1880 by other European countries, including

those of the so-called Latin Union; thus there was a widespread approximating to the monetary system which Britain established for herself in 1816. The movement in favour of gold was significant, emphasizing as it did, not alone the merits of the metal, but also the monetary genius of Britain whose rise as an investing nation was largely an outcome of her early perception of the basis of sound money and of that expression of her island temperament which led to an adventurous use of the power of credit. Whilst the monetary position of the United States in the 'seventies was ill-defined, paper money playing a prominent part in her currency, it can be said that since 1834 gold had been gradually rising to supremacy in the nation's currency arrangements. An attempt was made in the United States during 1893 to dethrone gold, or rather to give it a consort, but the "bimetallist" agitation on behalf of a double monetary standard died down, its demise being hastened by the melodramatic manner in which fallacious theories were expressed. The widespread acceptance of a gold standard does not ensure stability to the value of securities, not even to those guaranteed by powerful Governments; but for capital, as for commerce, the gold standard is a unifying factor lessening the area and the depth of possible financial disintegration. Adherence of countries to the principles of the gold standard must be held to have fostered the great expansion of investment which was so marked a financial feature of the early part of the twentieth century.

Dull Directors and Dishonest

The next item on our agenda is in a minor key, namely, a consideration of the possibility that some opponent of the capitalist system will take us to task if we fail to mention that the British Parliament in 1877 contained no fewer than 176 Railway Directors, all primed to defend in that

Assembly the "vested" interests of Railway Companies and their shareholders. It is true that the directors of Railway Companies in those days were more expected to exert their "influence" in their county and in their nation than they were to have any valuable knowledge of railway administrative problems. As a matter of fact, however, although the persistently heavy advocacy of the claims of Railway Companies may have been specially desirable in those days of pedestrian Parliaments, the Railway Companies were later to suffer by reason of the tradition of directorial dullness which they had created.

It was not merely the Railway Companies which went astray. Directorships of other companies were frequently obtained without real working qualifications in the Victorian dog-days. The man of title who is willing to decorate prospectuses of semi-fraudulent companies with his name and be a decoy for the uncritical investor has been with us since a rank breeze blew from the South Sea; under the designation of "guinea-pig" his vices are set forth in all dictionaries of any pretension. But the sin of dishonesty among directors in the times where we now find ourselves was neither as common nor as financially dangerous as the virtue of mediocrity, which few thought fit to pillory. As long as Britain had special advantages in the pursuit of foreign trade and her companies the various privileges which come from being first in the field, the absence of first-rate men at the head of her industries was not a serious matter to the country as a whole or to the investing classes. But as competition increased between nation and nation, and company and company, so it became evident that the fashion of ornamenting the Board Room would have to go out with the antimacassars; and for the same reason. Reposing on chairs was not in accord with the exacting demands of a strenuous age.

It must not be thought that directorial cupidity and

stupidity were entirely to blame for the tendency of companies to become organizations with neither a body to kick nor a soul to curse and, it might be added, a brain to think. Where shareholders in a concern are mostly working partners and sleeping partners the exception, there the personal element in business is pronounced. But if a shareholder is without pride in a company, is interested only in the dividends he receives, and is prepared to change quickly from a share in one business to a share in that business's rival if the action is likely to swell his bank balance, then, if intellectual apathy can be charged against directors, moral apathy is the deadly sin of many shareholders. It will be recollected that this was a danger foreseen by thinkers centuries before.

Walter Bagehot's Inquiry

Walter Bagehot had asked "How can a soul be a merchant?" but so far no one had made a similar inquiry with regard to the investor. The ethics, the philosophy, and, indeed, the physical science of investment were but little the occupations of the Victorians, who were chiefly content to receive, and when receipts declined in one direction to offset them from another, compensating opportunities not being lacking. John Stuart Mill had declared, with regard to investment abroad, that "the exportation of capital is an agent of great efficacy in extending the field of employment of that which remains: and it may truly be said that, up to a certain point, the more capital we send away, the more we shall possess and be able to retain at home." He probably had most in mind that the developing of other countries by British capital made available to the British manufacturer cheaper and more varied raw materials, and ensured ample supplies of food to the rapidly expanding British population. But British capital was serving other purposes as well; it was being used to develop

foreign and colonial industries which were to prove serious competitors with the industries of Britain, competitive at first in particular areas and then throughout the world.

Unemployment in 1878

An inkling of what was happening dawned upon many British business men in 1878, a year in which the percentage of wage-earners unable to obtain work was higher than at any time since the Napoleonic Wars. But there was no disposition to urge that the export of capital should be supervised so that it could be related to the wisest conceptions of the needs of the national economy. Dissatisfaction with business conditions in that year took the form of criticism of Free Trade, and pressure was brought upon the Government to reconsider the whole question of tariffs. But it was already a dogma with the City that a country which is a great lender must be willing to receive without hindrance the goods of those countries to which she has lent capital, since by so doing the earning of interest and the eventual repayment of the loans are facilitated. It was a point of view which was to command the direction of fiscal policy for another fifty years, and its abandonment then represented not so much a change of heart on the part of the City, as a reluctant yielding to a combination of circumstances necessitating the defence of the nation's currency through the restriction of her imports.

Further Reflections on the Flow of Capital

The flow of capital abroad might perhaps have been better directed, but a little reflection shows that nothing could have been gained in the long run by restricting capital investment to within the home country. The development of competing industries abroad would not have been prevented. Capital for that purpose would have been forthcoming from elsewhere; the trickle might

have been slower and thinner, but the ultimate result would have been the same. Nor can there be any doubt, in view of the haphazard way in which population then grew, that the food requirements of Great Britain necessitated the financing of supplies from abroad; but it is certainly an open question whether British agriculture need have been so nearly ruined in the process as it was. The Royal Commission of 1893 stated that agricultural values had diminished by one-half since 1875. Manufacturing industry had experienced no such setback in the period. It was the case that in the early 'nineties the rise of Germany and the United States as manufacturing countries had become marked, and in 1890 Britain lost first place as an iron-producing country. Nevertheless, the depression of the late 'seventies past, exports of British manufactures expanded; the course was irregular but exports for 1895 were £32 millions higher than for 1878, and net imports, that is, imports after allowance for deduction of re-exports, had increased by £40 millions.

British Capital Abroad in 1885 and 1895

We may note that Giffen estimated British capital abroad in 1885 as £1,302,000, and other estimators, basing their calculations on Giffen, have concluded that the amount of British capital invested abroad in 1895 was £1,600 millions. We regard this figure as an under-estimate and think that the amount was over £1,700 millions. However, taking the smaller figure of £1,600 millions, British capital abroad increased in the ten years by £298 millions. Exports in 1895 were only £13 millions higher than those for 1885. Modifying facts have to be taken into account, including that only part of the £298 millions was effective at any time during the ten years and during several years less than half. Further, the Index Number of Wholesale Prices for 1885 was 96, and for 1895 it was 83. If we were

to make a broad allowance for the fall in prices, as revealed by the Index Numbers, then exports in 1895 would be £46 millions higher than in 1885. Even so, the benefit of the British export of capital upon the export of goods during this period still does not seem an overwhelming one, although we must not overlook the advantage to home industry of the increase in receipts to British investors from interest on their investments abroad, an increase which, in spite of defaults, cannot have been less than £12 millions per annum.

An Analysis of Overseas Securities in 1893

It will be seen from the table given herewith of the Overseas Securities quoted on the Stock Exchange at the beginning of 1893, that the amount there shown as actually subscribed for foreign industrial companies formed a small proportion of the whole; but plainly much else of the money was spent in making transport and other conditions propitious for industrial development. The assumption

Overseas Securities Quoted on London Stock Exchange, January, 1893

(The figures represent the par value)

	£
Colonial Government Securities	225,000,000
Foreign Government Securities	525,000,000
Colonial & Foreign Corporation Stocks	20,000,000
Railways in British Possessions	75,000,000
,, ,, India	65,000,000
,, ,, United States	120,500,000
,, ,, Other Foreign Countries	127,500,000
Banks operating abroad	50,000,000
Foreign Breweries	3,500,000
Gas Companies operating abroad	6,500,000
Iron ,, ,, ,,	500,000
Land and Mortgage Companies	100,000,000
Tea Companies	2,500,000
Telegraph Companies	10,000,000
Waterworks Companies operating abroad	3,000,000
Tramway Companies operating abroad	4,000,000
Miscellaneous Companies—Colonial and Foreign	30,000,000
	£1,368,000,000

must not be made that all overseas securities subscribed and, so to speak, still living, were represented by Stock Exchange quotations; nevertheless, the percentage exclusion may be regarded as small. A more important consideration is that to the total of quoted British overseas investments at this time should be added banking deposits held abroad on behalf of Britons, representing, let us say, £50 millions, and private investments of some £250 millions, making the total of British overseas investments in 1893 round about £1,668 millions.

We Arrive at Christmas, 1895

In the next period of our survey we begin to hear the challenge of new industries; already in 1883 the artificial silk industry had begun to stir. There were as yet few signs of large industrial amalgamations; exceptionally, the Salt Union was building up a system of control of production and distribution, subsequently to become a general movement in British industry. But from the early 'eighties onwards absorption of small banks by large was markedly in evidence.

So we arrive at Christmas, 1895, fourteen years after Cecil Rhodes had formed his Chartered British South Africa Company, the time of "Jameson's Raid." Historians must pronounce upon the rights and wrongs of this famous incident; but all men know that it did not produce peace and goodwill: and what followed the Raid was to add £150 millions to the National Debt.

CHAPTER XVII

FROM 1896 TO 1913—FEVER AND PROSPERITY

A Victorian summer's day—An additional consideration—The last five years of the nineteenth century—The horseless carriage—Rigs, corners, and manipulations—"Exclusive information"—South African mining shares—The British attitude to foreign debtors—1896 to 1913—The surging impulse—Commodity prices and stock and share values—The Companies Acts—Prospectus applications—Reconstructions—The Cartel movement—Scientific finance—Railway capitalization—Founders' shares—Sir George Paish's calculation of British investments in colonial and foreign lands

It was on a Victorian summer's day that a general visiting cadets' quarters at Woolwich was almost overcome by the sight of flowers and pictures in some of the rooms; such ornaments were sentimental and superfluous, unworthy of those about to become soldiers and gentlemen. He voiced his indignation in a report upon which we happened to light while searching through Government papers to get information for this volume. Regrettably the general's thunder came to us rather late; for our labours were then well advanced. Nevertheless, we applied the moral to ourselves as drastically as we could. The lesson we drew was that we should not indulge in period decoration. Consequently, the years from 1896 to 1913 will be sparingly dealt with, receiving only one chapter of treatment.

It must be confessed that martial tones heard from the fleeting past are not the sole influence in bringing us to this decision; there is the additional consideration that we have by this stage of our journey touched upon many incidents which tend to repeat themselves with just the little difference needed to make history. We should gain little by going over similar ground again, even though we were moving forward. Therefore, even facts as subtly flavoured as the discovery by China of the delights of foreign

borrowing or as crude as the American financial frenzy of 1907 come merely in the category of our unconcern.

From 1895 to 1900: The "Horseless Carriage"

The last five years of the nineteenth century were not of a kind wherein constructive financial criticism was given much heed, although in 1900 the Companies Acts were once more tinkered with. Activities on the Stock Exchange during these five years were both feverish and unsavoury. Not all of the factors contributing to the fever were of a reprehensible kind; for example, we cannot condemn the stimulus provided by new inventions. These were the early days of the "horseless carriage," and presumably people who risked their money in the first motor-car companies rendered a service to mankind. A curious feature of the times was the amount of new capital supplied to brewery undertakings, £36 millions being subscribed in the two years 1896 and 1897—in the latter year £8 millions more than was subscribed for Foreign Loans and £2½ millions more than for home industrial manufacturing companies. The esteem in which brewery company shares were held can be seen from the fact that in 1896 Guinness shares rose from 490 to nearly 700.

Rigs, corners, and manipulations generally were the order of the day, the month, and the year. Some newspapers strove hard to protect the public from exploitation, but although it was a period of great City Editors, corruption of the minor financial journalist was extensive; for a consideration shares were recommended in the Press or, at least, adverse comment withheld.

"Exclusive" Information: South African Mining Shares

The man with any experience of the financial world will suspect that something of this kind is always going

on, as he will also that in a large number of cases the "exclusive" information concerning the alleged good fortune of a company which adorns the financial columns of the Press has not been supplied from the purest of motives. His doubt will not be removed although the financial writer may obviously have penned the news in proud consciousness of being a recipient of disinterested confidence. We feel no call to linger over the commonplaces of human frailty; yet we should set down that in one direction the manipulation of prices in the 'nineties became more than a local menace. The market value of the shares of forty-one South African mining companies in 1895 was nearly £122 millions; by April, 1897, it was scarcely a third of this figure. An explanation was required and a dangerous one was to hand. "And now," commented *The Economist*, "shareholders are being told that their losses have arisen almost solely from the hostility of the Boer Government and the repressive character of the taxation which is throttling the industry; that, in fact, there will be no improvement until those who are anxious to plunge the Transvaal into war have their way."

British Attitude to Foreign Debtors

The resentful comment was justified, even though the riches of some of the South African mines proved to be greater than had been anticipated by the most sanguine, and though pin-pricking by the Boer Government did take place. But Egypt, the Transvaal, and a few lesser instances notwithstanding, the connection between British foreign policy and the claims of British stock or share holders has been on the whole of a milder kind than is sometimes alleged by those who have studied the subject from the angle of pre-judgment. Indeed, generally speaking, the British attitude to the debtor overdue with his payments, whether that debtor be of home or of foreign

nationality, has been one of a restraint carried to the extent of generosity. It may be observed, as bearing on this matter, that in 1897 the executive of the Corporation of Foreign Bondholders was subjected to severe criticism by some of the Corporation's supporters on the ground of an allegedly too lenient treatment of defaulting foreign Governments. Conceivably, what was deemed to be excessive leniency proceeded from a clearer recognition by the executive of its own responsibilities and powers than was palpable to outsiders. Be that as it may, the City as a whole expressed its approval of the conciliatory policy which the executive pursued.

1896 TO 1913: A PROSPEROUS PERIOD

Apply any test you will and the period from 1896 to 1913 is revealed as one of almost startling prosperity. Deposits in joint stock banks increased by more than 50 per cent, the number of joint stock companies rose from 19,400 to 60,700, and the paid-up capital from £1,026 millions, to £2,425 millions. Exports of the produce of the United Kingdom increased from £226 millions to £525 millions and re-exports of imported produce nearly doubled in amount. Despite the Boer War the total National Debt by 1913 had been reduced to a figure almost identical with that of 1895; in 1913 subscriptions of new capital reached £248 millions, or nearly £100 millions more than for 1896. This prosperity is traceable to a variety of causes; but the great surging impulse was the increase in the world's output of gold from less than £41 millions in 1895 to £97½ millions in 1913, an increase which led to expansion of credit and currency and a consequent upward drive of the purchasing power of large numbers of people. Therefore, excepting for a few temporary recessions, the period of our present consideration was one of rising prices stimulating trade activity. Sauerbeck's Index of Food Prices for 1895

was 64, and for Raw Materials 60. The corresponding figures for 1913 were 77 and 91, indicating that during the eighteen years food prices rose by approximately 20 per cent, and raw materials by 50 per cent. It can be said for all practical purposes that wages kept pace with the increase in the cost of living; indeed, from 1896 to 1903 the real value of wages slightly advanced.

Commodity Prices and Security Values

The effect of a rise in commodity prices upon stocks and shares is to cause a fall in the value of fixed interest securities and fixed dividend shares, since obviously the purchasing power of a given rate of interest is lower when the Commodity Index is, let us say, 120, than it was when the Index was 100, assuming that no change has been made in the method of compiling the Index. Such a statement as the foregoing, like most others we venture in this tantalizing world, needs qualification. It may happen anomalously that fixed interest securities are maintained in price on the Stock Exchange although appreciation in prices of commodities is taking place. But this rarely happens save when a large number of people believe that financial conditions are so bad that only obligations of the strongest Governments and the first charges of the strongest industries are likely to be met regularly for a lengthy period ahead. However, as a rise in commodity prices, if it occurs in response to genuine trade demands, foreshadows an increased ability of companies to earn profits, the maintenance of prices of fixed interest securities in face of that phenomenon cannot be sustained indefinitely. The better prospect for dividends on Ordinary Shares leads to a considerable transfer into those Shares of money until then invested in fixed interest securities; the transfer is an inevitable and precautionary movement prompted by the endeavour to ensure that the return on

holdings of securities may as far as possible keep pace with an increasing cost of living.

The Companies Acts

It has been mentioned earlier that in 1900 another Companies Act was passed. This followed on fifteen similar Acts made law between 1862 and 1890; in 1908 and 1929 also Consolidated Companies Acts with additional provisions came into force. The halting and piecemeal progress towards making company legislation comprehensive is capable of many illustrations; one instance is that until 1901 only banking companies registered after 15th August, 1879, were compelled by law to have their accounts audited. Other companies were governed solely by their own regulations as to audit. The Companies Act of 1900 stipulated that an annual audit should henceforth be made of the accounts of all companies registered under the Companies Acts.

Many of the thousand and one provisions of the Companies Acts have no direct application to the investor and many more apply to him only under rare circumstances. We may note, however, as of an outstanding importance to shareholders' pockets, two provisions of the 1908 Act which remain unaltered in the Act of twenty-one years later. The first is that if an investor has applied for shares in a company by means of an application form in a prospectus and has received a "letter" from the company indicating that shares have been allotted to him he cannot withdraw his application. He is legally liable for the payment of all calls upon these shares. Naturally, such a statement as the foregoing does not imply that the investor has no remedy if there has been any material misrepresentation in the prospectus; but if he contemplates taking action on these grounds he must not attempt to sell the shares allotted to him. The second provision is that when

a company is reconstructed a shareholder who has not yet voted in favour of reconstruction may avoid participating in a reconstructed company if he expresses his dissent within seven days from the confirmation of the resolution. His interest in the company has then to be purchased by the liquidator. This right is important, because often the reconstruction of a company involves the creation of a fresh liability on a share, and the shareholder who does not dissent within the prescribed time is legally responsible for that liability. It may be added that it is not always easy to decide whether or no to participate in a reconstruction. Occasionally, reconstruction and the provision of further funds has been followed by prosperity. But company history shows that in an overwhelming majority of cases to join in a reconstruction is to lose more money, and whilst an investor should weigh carefully the merits of a particular case he would be wise not to let the arguments of the moment entirely obscure the relevant evidence of cumulative experience.

The Cartel Movement

A development within the period from 1896 to 1913 which was to prove of fundamental importance to British investors and indeed to investors generally, was the beginning on the Continent round about 1900 of the Cartel Movement in Industry. This movement was to develop steadily until a quarter of a century later it became allied with something of still more profound significance, namely, the body of principles then being determined and classified under the general heading of Rationalization. The rise of Cartels in Europe, as to a lesser extent also the rise of Trusts in the United States, was the outcome of a desire to regulate the output of industry in order that the price of the product of that industry should be maintained. The Cartel, however, consisted of a number of companies

which retained their separate identity and management, and which were linked together merely by certain agreements formulating a common policy limited in scope. The Trust, on the contrary, actually absorbed companies, or sought to eliminate them by undercutting prices or by other means. It has been contended by some commentators that both Cartels and Trusts had for their sole object the exploitation of the consumer; such a view of Trusts was for long taken by the United States Government, which passed much restrictive legislation designed to hamper the Trusts' activities. But whilst the desire to charge the consumer the utmost he could afford may have been one of the causes of the origin of the Cartel and Trust movements, there were contributory influences not necessarily of an anti-social kind. Some bound had to be set to the competitive struggle which had been so distinguishing a feature of capitalism in action; otherwise the struggle would degenerate into a wasteful conflict. Then, too, the idea of scientific direction of industry was emerging and required for its growth the acceptance of a conception of large productive and distributive units.

Scientific Finance

It was the case with finance also. The French in particular had been long noteworthy for the scientific financial methods of their large corporations; the Germans had followed and Britons were feeling their way. We find British experts in the late 'nineties admitting that home companies had much to learn in the matter of financial technique. It was said that Britain had been the pioneer of the joint stock system, but she had pursued in private finance the path of expediency, although her system of public finance remained unequalled by that of any other country. Criticism was specially directed at the form of capitalizations of British railways, which were burdened

by large amounts of irredeemable debentures. It was pointed out that had the companies retained the right to redeem Debentures these could have been renewed on advantageous terms and the Ordinary shareholder would have received more in dividends. It must be observed, however, that if the Debentures had been redeemable at the option of the company, the power to renew them in the 'nineties at a low rate of interest would have been attributable to the phenomenally and, perhaps, unjustifiably low rates of interest obtainable during these years on other fixed interest securities, notably on Consols. Nevertheless, this recognized, it would yet be true that the finance of a company should be so arranged that the shareholders, rather than the debt holders, were able to derive benefit from favourable monetary conditions, whatever the originating cause of these last. It was not only in the direction of giving holders of debt obligations unwarranted privileges that British company finance was assailable at this time; another weakness proceeded from the fact that little attention had been given to relating different classes of shares to the requirements of a soundly-balanced capital structure. An infrequent evil, but one which was to be provocative of strife between shareholders and directors of several prominent companies was the existence of Founders' Shares. These shares formed only a very small proportion of the total capital and conferred on the fortunate holders enormous claims on the earnings of a company; in the case of the Burma Ruby Mines, for example, to the extent of one half.

Sir George Paish on Britain's Investments Overseas

We may bring our survey up to the year 1913 by concluding with a reference to the most thorough-going estimate that has been made so far of the amount of capital

THE AMOUNT OF CAPITAL PUBLICLY INVESTED BY GREAT BRITAIN IN OTHER LANDS—AS AT DECEMBER, 1913

Geographical Distribution

	£
Canada and Newfoundland	514,870,000
Australia	332,112,000
New Zealand	84,334,000
Africa—South	370,192,000
,, —West	37,305,000
India and Ceylon	378,776,000
Straits Settlements	27,293,000
Hong Kong	3,104,000
British North Borneo	5,820,000
Other Asiatic Colonies	26,189,000
Total India and the Colonies	£1,779,995,000
	£
United States	754,617,000
Cuba	33,075,000
Philippines	8,217,000
Argentina	319,565,000
Brazil	147,967,000
Mexico	99,019,000
Chili	61,143,000
Uruguay	36,124,000
Peru	34,173,000
Miscellaneous American	25,538,000
Russia	66,627,000
Egypt	44,912,000
Spain	19,057,000
Turkey	18,696,000
Italy	12,440,000
Portugal	8,136,000
France	8,020,000
Germany	6,364,000
Miscellaneous European	54,580,000
Japan	62,816,000
China	43,883,000
Miscellaneous Foreign other than European or American	69,697,000
Total Foreign	£1,934,666,000
Grand Total	£3,714,661,000

Purposes

	£
Colonial Governments	675,464,000
Foreign Governments	284,059,000
Total Government Loans	959,523,000
Municipal	147,547,000
Colonial Railways	306,460,000
Indian Railways	140,796,000
American Railways	616,581,000
Foreign Railways	457,177,000
Total Railways	£1,521,014,000
	£
Banks	72,909,000
Breweries	17,980,000
Canals and Docks	7,111,000
Commercial and Industrial	145,332,000
Electric Lighting and Power	27,310,000
Financial, Land and Investment	244,187,000
Gas and Water	29,216,000
Insurance	246,000
Iron, Coal, and Steel	30,535,000
Mines	272,789,000
Motor Traction, etc.	1,059,000
Nitrate	11,623,000
Oil	40,579,000
Rubber	40,982,000
Shipping	794,000
Tea and Coffee	22,443,000
Telegraphs and Telephones	43,692,000
Tramways	77,790,000
Total Industrial, etc.	£1,086,577,000
Grand Total	£3,714,661,000

publicly invested by Great Britain in other lands. This was undertaken by Sir George Paish in 1907 and subsequently revised by him to show the position at the end of 1913. He calculated that at the end of 1907 British investments in Colonial and Foreign Lands by means of publicly issued securities amounted to £2,700 millions. If we take data published with this calculation and also further data issued by the Inland Revenue Department then it appears that the income derived in 1907 from approximately the foregoing amount of capital was £137 millions or an average of slightly over 5 per cent. These figures show that the charge by British investors for lending capital abroad had been moderate; indeed, markedly so, when regard is had to the risk in a number of directions where the money was employed. In the six years from the end of 1907 Britain invested abroad another £1,014 millions, making a total of £3,714 millions at the end of 1913. The geographical distribution of the capital and the purposes to which the capital was applied are shown in the tables given on page 175.

It was the opinion of Sir George Paish that the greater part of the advantages arising from the constructive work represented by the above capital expenditure had yet to be realized. Before those additional advantages could be reaped, however, there was to be a harvest of another kind.

CHAPTER XVIII

CHIEFLY OF TRAGEDY AND FOLLY

1914-18—Britain's war borrowings—Myriad thickets—Unstable money—Securities—War time—New capital, 1919 and 1920—Rampant speculation—Fallacious days—The domestic scene—Crops of financiers—The 1929 forgeries—A Guarantee Fund—The Royal Mail case—Collapse, and the causes—Financial frenzy in the United States—The fall in prices

BRITAIN'S borrowings for the purpose of the World War of 1914–1918 created over £7,000 millions of loans, wherein the money of very many people was placed; but the magnitude of the operations and the widening of the circle of lenders to the Government cannot be accepted as convincing evidence that here was any growth of investment in the strict sense of the word. If the money so provided had not to be used for destructive purposes and had been economically and creatively employed, then a different view could be taken. But, as matters were, the money was inevitably devoted to impoverishing the nations, including Great Britain herself. Therefore, although we are bound for the sake of completeness to show the increase in the nation's deadweight debt and in the charges for interest and management during these years and immediately

GREAT BRITAIN'S DEADWEIGHT DEBT

On 31st March	Internal	External	Total	Interest and Management Charge
	£	£	£	£
1914	649,770,000	none	649,770,000	24,500,000
1915	1,104,967,000	none	1,104,967,000	58,080,000
1916	2,072,531,000	60,617,000	2,133,148,000	60,249,000
1917	3,611,134,000	400,311,000	4,011,445,000	127,250,000
1918	4,823,176,000	1,048,673,000	5,871,849,000	189,851,000
1919	6,070,099,000	1,364,850,000	7,434,949,000	269,964,000
1920	6,550,065,000	1,278,714,000	7,828,779,000	332,033,000

afterward, we are not called upon to examine in detail the terms of the various War Loans issued in Great Britain. In other words, we regard the War Debt as having multiplied the financial obligations of the nation without having added to the real capital of the people, whereas the function of true investment is to facilitate the production or the distribution of wealth.

Each Government in its turn sought by Conversion Schemes to reduce the burden of the interest charges, but it cannot be said that much headway was made until the year 1932, when over £2,000 millions of 5 per cent War Loan was placed on a 3½ per cent basis. That remarkable operation is dealt with extensively in later pages. Meanwhile we have to mark the course of events from 1914 onwards in as serial fashion as is possible and in so far as it is germane to our theme.

War and Post-War Confusion

We have already indicated that our guiding principle in dealing with the Government loans of these years is that of exclusion of detail; the principle is one which we must apply generally, if we are not to lose ourselves in the myriad thickets of war and post-war confusion. Therefore, consideration of the emergency financial legislation of the years from 1914 to 1918 will not occupy us; we shall not dwell upon the circumstances of the closing of the Stock Exchange from August, 1914, to January, 1915, or the manner of dealing with the immediately pre-war Stock Exchange Account, which was not entirely liquidated until 1922. It is not easy at this cataclysmic stage of our investigations to separate the extraneous from what should be regarded as genuine and enduring influences, hastening or otherwise modifying the evolutionary factors of investment; for in the words of a terse summary by the League of Nations, "The war and subsequent changes

and disturbances profoundly affected the economic structure and activity of the world. In Europe, wealth was destroyed on an unprecedented scale; plant in excess of normal requirements was constructed in a number of industries to meet the special needs of warfare; monetary systems were disorganized and public debts enormously increased; the accumulation of capital was checked by inflation; Russia completely changed her economic and social system; and new territorial divisions were created. In other continents, the area under cultivation of the principal food crops was rapidly increased; new industries were built up by countries which were formerly markets for European products; and the United States of America, from being a debtor became a great creditor nation. As between all countries, free intercourse was long subject to legal restrictions."

Unstable Money

We are moving in a world where by the end of 1914 the money values of many nations were rapidly losing any economic basis and were coming more and more to depend for their maintenance largely upon a combination of patriotism and make-believe. The world was being flooded with paper money, and the most monstrous debasement of currency and credit known to history was to proceed with varying degrees of intensity for long after the War had closed: some nations were to make their currency worthless.

Great Britain's increase of paper money during the War was moderate compared with the increases of most other belligerents, but whereas in 1914 her total note circulation was £95 millions, by the end of 1919 it was £504¾ millions. The Bank of England's gold holdings increased in the period from £69½ millions to nearly £91½ millions. Thus we have a position wherein the nation's central gold

holdings increased by one-third and the note circulation five-fold. Under these circumstances of uneconomic monetary values, Indexes of the trend of security prices at this time have but limited application. Nevertheless, the figures from the Bankers' Magazine Index given below have significance; the base value in each case is 100 and is for the year 1913.

VALUE OF STOCK EXCHANGE SECURITIES IN NOVEMBER, 1918, AS MEASURED BY STOCK EXCHANGE QUOTATIONS.
BRITISH

Govt.	Rlys.	Bank	Insurance	Iron, Coal, and Steel	Shipping	Electric Light and Power	South African Mining
86	78	98	116	108	174	86	92

It will be seen that insurance, iron, coal and steel, and shipping companies were concerns benefiting from War conditions. Insurance companies were to continue to experience a special demand for their services long after the War had ceased, as a large proportion of the War gratuities received by demobilized soldiers was used for the taking out of insurance policies. Shipping companies thrived on the extremely high freight rates obtainable during the times that submarines made passages perilous, and iron, coal, and steel companies flourished to a lesser extent on the manufacture of munitions, although the Excess Profits Tax took heavy toll of all abnormal profits. Expansion of shipping induced by the prospect of making a fortune in a single voyage took place at a rate far beyond what was required to make good the sinkings of War and to supply the normal needs of mankind. Thus, the world launchings of new vessels from 1907 to 1913 inclusive were 17 million tons, and from 1914 to 1920 over 27 million tons; consequently, soon after 1920 large amounts of shipping became idle.

New Capital in 1919 and 1920: Rampant Speculation

New capital for joint stock undertakings raised in Great Britain during 1919 and 1920 amounted to £481 millions, of which four-fifths was for purposes of home industry and finance, it being anticipated that business would speedily return to normal and indeed to a state of prosperity far exceeding that of 1913. The sum of £61 millions was used for the further modernizing of the iron and steel industries, the productive capacity of which had been already made gigantic to satisfy the appetite of war. The assumption was widespread that the effects of Armageddon could be surmounted in a night, an assumption which, blending with the still existing currency inflation, had among other results a soaring of prices on the Stock Exchange.

Sauerbeck's Index of Wholesale Prices of Commodities for 1914 was 85, for 1918 two and a quarter times that figure, and for 1920 nearly three times. Bank Rate was raised in order to check the rampant speculation, and for 1920 the average Bank Rate was approximately 6¾ per cent, and for 1921 slightly over 6 per cent, both being higher averages than ever previously recorded for whole years. The highest average Bank Rate during the War was a little under 5½ per cent for 1916. The Commodity Price Index for 1922 had fallen to 131, or about half that of 1920, but it was not until 1923 that any severe recession in quotations of stocks and shares occurred. General deflation of Stock Exchange prices was delayed until the world-wide commercial crisis of 1929, the fall being therefore all the more drastic and recovery from it the more difficult. An idea of the extent to which Stock Exchange quotations unjustifiably rose can be gathered from the fact that in 1922 the net improvement in the market value of 387 fixed interest and variable dividend securities was

£712 millions or 13·2 per cent; the actual percentage appreciation in 38 industrial and commercial shares being 34·3 per cent. It is true that a certain number of advantageously placed industries were adding to their profits and managed to do so until the end of 1926 when, partly by reason of a prolonged dispute between coal miners and coal owners and partly from deeper disintegrating forces, the eclipse of British industry proceeded apace. But there was not much rhyme or reason for the appreciation of security values in 1922: long before the close of that year a million and a half workers were registered on the books of the Labour Exchanges as unemployed.

Fallacious Days

However, those were the fallacious days of belief in the ultimate receipt of huge Reparation payments from Germany, which country had already begun to borrow heavily abroad, using some of the receipts for meeting Reparation demands destined to grow beautifully less from year to year; the by no means negligible remaining receipts were used for improving public buildings and the like or for the making of her industries more efficient than those of her conquerors. A few people in Great Britain detected the chuckles of Mephistopheles while this was going on, but it was not generally perceived that this process of paying back Paul a proportion of his own money would lead to the cessation of the so-called Reparation payments and to the creation by Germany of international debts to be met this year, next year, or never.

The Domestic Scene

The domestic financial scene in Great Britain was enlivened by a mania for the amalgamating and recapitalizing of companies. This obsession had nothing to do with a scientific approach to financial and industrial problems;

companies were married with no thought of what was to be the practical outcome, to-morrow being left to take care of itself, while to-day was devoted to the copious watering of capital. Thanks to the arbitrary way in which the god of war dispenses his cash rewards, many small men of vaulting ambition had sufficient money to lift them temporarily to power in the City; these men obtained the financial control of old established and highly reputable companies. The Lancashire textile industry in especial suffered a descent from London visitors fully able to prove that their complete absence of technical knowledge was a boon of inestimable value.

Crops of Financiers

It was not very long before the high-falutin notions of this type of financier were disproved and he retired or was thrust into obscurity, leaving the industries which he had come to bless in a worse state than he had found them. Only a few years were to elapse before there sprang up another crop of directors who by their incapacity or worse were to lighten the pockets and burden the hearts of many credulous people. These gentlemen were active not in the wild re-shaping of old things but in making new ventures appear so sure and certain that the most conservatively minded would supply money for the manufacture of devices and products which so far had never been produced outside of a laboratory and in some cases not even there. In 1928 the total amount subscribed for capital issues of 248 companies was £117 millions; by May, 1931, the total market value of these issues was £66 millions, seventy of the companies had completely disappeared, and thirty-six more had a faint semblance of life, although their shares had no market value. Whilst it is the case that a few stock-brokers played a wholly discreditable part in helping to foist the shares of the above companies on the public at

unwarranted prices, many stockbrokers vainly tried to dissuade their clients from making purchases of this kind. The stockbroking profession as a body is powerless to diminish appreciably the recurrent gambling fever of the public.

The 1929 Forgeries

Toward the end of 1929 a startled City learnt that a prominent financier and his associates had forged the share certificates of English corporations and had used the false scrip so created in order to obtain extensive advances from banks. Not only were banks involved, but stockbrokers and stock jobbers as well; the frauds were on such an extensive scale as to cause serious financial embarrassment in the City. Members of the Stock Exchange met the situation by raising at short notice a Guarantee Fund of £1 million, so preventing the failure of such of their number as were actually victims of the fraud, and saving the public from enduring losses which default by Stock Exchange firms would have entailed. These happenings led to a demand on the part of some people that the Stock Exchange as an Institution should have a permanent guarantee fund to meet emergencies, and that the raising of a fund should not be left to voluntary effort. Theoretically the creation of an Institution Fund has much to commend it; on the other hand, far-reaching frauds of a kind affecting any considerable number of Stock Exchange members are extremely rare. Certainly, the Stock Exchange gained more in prestige by its swift co-operative action than it would have done from the automatic administration of a compulsorily subscribed Reserve Fund.

The Royal Mail Case

With regard to a number of other financial scandals which blemished the City about this time we need only

take note of that in connection with the Royal Mail Steamship Company, whose shares had been for long regarded as one of the finest of investments. The Chairman was found guilty of a deceptive prospectus. The actual circumstances of the mis-statement are not our concern, but we may remark that the Royal Mail episode provided an illustration of the folly of investors trusting entirely to the fact that a company is old established and has had a successful dividend record. These are important factors, but they do not obviate the necessity of closely scrutinizing Balance Sheets and Articles of Association. For many years before 1929 the form of the Balance Sheet of the Royal Mail had been severely criticized by leading financial journals, which had complained of the inadequacy of the information the Balance Sheet set forth. Admittedly, the directors of some of the most successful companies believe in giving shareholders the minimum of information, but that does not alter the fact that the principle is wrong; if only from the reason of bringing about a change of this cavalier attitude investors should refrain from putting their money into "close" companies, as they are termed. But with the Royal Mail it was not only a case of an uninforming Balance Sheet; the way of remunerating the Chairman was thoroughly unsound, taking the form of a commission on turnover and being dependent on the payment of a dividend of not below 5 per cent annually. It will be evident that under such arrangements there is a strong temptation to pay a dividend, although it may not have been truly earned, and to trust to the making of some kind of adjustment in the following year. It might be suggested that any such danger should be removed, in actual practice, by the supervision of the directors as a body; however, it is but seldom that a board as a whole has a close grip of financial technique.

The two episodes referred to above occurred shortly

after the Companies Act of 1929, which contained a hundred or so clauses designed to afford the public additional protection. The Bill strengthened very much the powers of committees of inspection, whether appointed by shareholders or by the Board of Trade.

Collapse, and the Causes

Serious although they were, the excesses of new financiers and directors and the lapses of old played a minor part in bringing about the drastic collapse of Stock Exchange prices in process on the Stock Exchange from 1929 to well into 1932. The collapse was due to a combination of causes in which we may include that unduly large payments to her unemployed had caused Great Britain to live beyond her means, but more especially the collapse was attributable to the action of the United States and France in preventing gold from fulfilling its international functions, ever-increasing tariffs on the part of numerous countries, and giddy sky-rocketing of share prices by the American public. The world had nothing to complain of as far as the flow of capital was concerned. Taking as our measure the period from the end of 1922 to the end of 1929, Great Britain supplied to overseas borrowers £847 millions of new capital against £1,127 millions for the seven years to the end of 1913: during the period, however, the United States emerged as a foreign lender on a great scale, the foreign investments of its people at the end of 1929 standing at over £3,000 millions compared with a few hundred millions at the end of 1913. But whereas Great Britain's policy as a foreign lender had been to encourage imports into her own country, recognizing that these were an important means of earning interest on money borrowed, and providing for capital redemption, the United States, on the other hand, intensified its traditional tariff policy. A result was that those of the United

States debtors who had gold had perforce to remit the metal to that country, at first chiefly in payment for goods supplied during the War and early post-war years and later to meet interest on Debt. Great Britain had to send large amounts of gold for the purpose of satisfying claims in connection with the loans which Great Britain contracted with the United States in order to finance her own and the United States' Allies during the World War. Gradually, debtors began to default on their obligations, not only to the United States but to Great Britain also.

Financial Frenzy in the United States

Meanwhile, the American public ushered in the new era. Between 1920 and the early part of 1929 prices of Industrial Shares in the United States, according to Index compilations, quadrupled as a result of incessant demand. It did not matter that the price of a share had already risen to a figure making the yield less than 1 per cent when related to the current earnings of a company; the share was bought because what the company was earning was in the common estimation nothing to what it would earn one day. Everyone gambled in shares—chambermaids and ladies of leisure, dancing masters and sedate pastors, bricklayers and clerks, brokers and bankers. It was not on this occasion an instance of a section of the public being snared by astute manipulators. One and all believed that the financial frenzy was justified by the near approach of eternal financial bliss for every man, woman, and child, provided that they were white, while coloured people were to blow the organs on Sunday in order that paeans of praise might be of acceptable volume to the Ruler of flowers and kind words that never die, little children, and the lovely trees that provide the clean white paper of which share certificates are made. Englishmen joined in the fun and a large business was transacted by London

stockbrokers. But sad to say, Englishmen were sceptical of the solidity of the foundations of the rise in American shares and practically all English money was safely home again before the collapse. By the end of June, 1932, prices of leading American Ordinary Shares, measured by the same Index we have previously used, were less than one-fifth of what they were at the end of 1929.

The Fall in Prices

The terrific fall in the prices of American Shares, revealing as it did a cavernous honeycomb of economic rottenness, shook the world, and quotations of stocks and shares tumbled everywhere. Steady absorption of gold by the United States and France, more particularly by the latter, still went merrily on, and largely as a consequence of this irrational suction Great Britain in September, 1931, was compelled temporarily to suspend the gold standard. Commercial and financial demoralization deepened the world over: by the end of 1931 prices of principal commodities were below the levels of 1913; but, even so, stocks of unsold commodities were accumulating in various countries. "The rapid fall in prices," said a League of Nations Report, "is one of the most important manifestations of the economic crisis and at the same time one of its most significant causes. A sudden decline in commodity prices, unrelated to changes in methods or costs of production, involves a reduction or the entire elimination of profits; business enterprises are closed down or work only part time; new investment is discouraged; men are thrown out of employment; the demand for commodities is reduced and prices fall still farther. A fall in the price of commodities begets a belief in further falls; prospective buyers withhold their purchases and thus add to the forces tending to depress prices." So also with stocks and shares; the great mass of the investing

public holds off a falling market and buys when prices are rising, irrespective of whether the appreciation is in response to economic forces, or has been spuriously engendered.

Thus the farcical tragedy went on; world trade for the first quarter of 1933, measured by prices, was one-third of that for the corresponding period of 1929; the decline in profits was even more severe. Nations and individuals the world over were vastly more in debt than they had ever been before, and most of them vastly less able to meet their financial liabilities than they had ever expected to be.

CHAPTER XIX

1927–1933: STATE CONVERSION AND COMPANY RATIONALIZATION

DEVELOPMENTS in 1931—Foreign withdrawals—A National Government—2 per cent Bank Rate—The War Loan saving—The French Conversion—The Stock Exchange Quotations, 1930–1932—Sir Alfred Mond—Rationalization—An amalgamation danger—Imperial Chemical Industries—Its results and balance sheet—A complaint—Unilever—Turner & Newall—Kreuger & Toll, and the Swedish Match—Some general reflections on rationalization

ALTHOUGH the general financial and commercial position of the world at the beginning of 1933 was ebon-hued, the situation of the London Stock Exchange was healthier than at any time since the War. Prolonged adversity had eliminated many of the weaker holders of securities; forced selling, as a result of pressure by banks for repayment of loans, had by this date fallen to small dimensions. The paramount cause of improvement, however, was the success attending the British Government's financial policy.

THE NATIONAL CRISIS OF AUGUST, 1931

Selling of British securities had been pronounced for some months before Great Britain suspended the gold standard, particularly by foreign holders. The appointment early in 1931 of an official Committee to inquire into the national expenditures of Great Britain and that Committee's vehement conclusion that Great Britain would have forthwith to reduce her outlays by £96½ millions per annum led many people in other countries to infer that the British nation was on the high road to bankruptcy. What was not realized by those so alarmed was that the British people as a nation are extremely practical

in financial matters and that once financial necessities are made plain they have no hesitation in grasping the nettle. Then, too, few nations at this time were not over-spending, although populaces were unaware of the fact. Britain had an advantage in that her people were early acquainted with actualities. By August, 1931, the withdrawal of foreign funds from Great Britain had become so extensive that the Bank of England found it necessary to obtain credits from the Federal Reserve Bank of New York and from the Bank of France, while power was taken temporarily to raise the fiduciary issue, that is, the issue not specifically related to gold. This sequence of events brought about the appointment of a National Government in Great Britain which received a vote of confidence in both Houses of Parliament, and subsequently of the whole nation. This Government was pledged to balance the Budget, curtail national expenditure, and to distribute the burden and sacrifices equitably among all classes. It was believed that the appointment of a National Government so pledged and commanding such wide support would be sufficient to restore confidence, that foreign funds would flow back to London, and that it would prove possible for Great Britain to maintain the Gold Standard. But the drain upon Great Britain continued, and on 21st September Great Britain suspended the Gold Standard to which she had returned in 1925 after the eleven years' suspension caused by the War. Less than six months later not only did the continental funds withdrawn from Britain return; large additional sums were invested in sterling securities. Confidence in the finances of other nations had decreased, especially in those of the United States where a multitude of small banks with substantial deposits in the aggregate were closing their doors as a result of having lent money on preposterously over-valued securities and real estate.

5 PER CENT WAR LOAN ANNOUNCEMENT, 30TH JUNE, 1932

Meanwhile, the British Government and the Court of the Bank of England pursued a vigorous policy of lowering the price of money, that is, of lowering the rate at which money could be borrowed. Between January and June, 1932, the Bank of England Rate was lowered five times and eventually reposed at 2 per cent. This was 4 per cent lower than at the beginning of the year and as low as the lowest Bank Rate previously recorded, namely, in 1895.

Then came perhaps the boldest stroke ever made in British Government finance. The Government had had the right since 1929 to redeem £2,085 millions of 5 per cent War Loan. It was evident that to accomplish redemption successfully would be no easy task; the amount at stake was so vast that if any substantial number of holders had declined to accept in exchange for 5 per cent War Loan a new security bearing a lower rate of interest and demanded cash, the strain upon the nation's financial capabilities would have been dangerous. Indeed, the view was held by experts that the only safe course was to attempt conversion piecemeal, and it was also thought that only a small reduction in the rate of interest could be wisely essayed.

But the Chancellor of the Exchequer, acting no doubt after close consultation with the Governor of the Bank of England, elected to endeavour to put the whole of this amount of War Loan on a 3½ per cent basis. As this loan played an almost predominating part in determining the rate of British Government long term credit, Mr. Chamberlain was boldly contending that British Government credit deserved to be 1½ per cent better than it was a year previously, that is before Great Britain suspended the gold standard.

The Saving Secured

Holders of 92 per cent of War Loan accepted the offer, leaving approximately £165 millions to be paid off in cash, an amount skilfully found by issuing to willing buyers Government securities bearing only 3 per cent interest. Whilst it is true that by fair comparisons the standard of British Government credit deserved to rank higher at this time than that of any other nation, Mr. Chamberlain had to thank the patriotism and acumen of the British people for the overwhelming measure of success he achieved. It was conceded by all sorts and conditions of investors that it would be a good thing for the nation if the annual amount required for War Loan interest could be reduced. The saving to the National Exchequer was the consideration given most heed; but there was also the extremely important fact that while Government securities were returning 5 per cent, industrial and other undertakings seeking to raise new capital or to borrow privately, had to offer a rate of dividend or interest considerably over the 5 per cent obtainable on securities with Britain's guarantee behind them. If trade had been flourishing and commodity prices rising this would have caused no hardship, but with the reverse the case, borrowing at 6 per cent or over for industrial purposes was often a hazardous venture. The success of the British Government's Conversion Scheme benefited industry not only in this respect; it also enabled those companies which had the right to redeem debentures to offer in exchange securities bearing a lower rate of interest, thus lessening the overhead charges of the companies. In addition to the War Loan, the British Government was able to effect certain other minor conversions and reductions in debt charges, the gross saving of all the operations for 1932, major and minor, amounting to £38 millions per annum.

The French Conversion

It may be remarked that in 1932 the French Government also carried out a Conversion Scheme, the loans involved amounting to rather less than half the amount of the British War Loan so dealt with. Although France was on the gold standard and her Central Bank had four and a half times as much gold as the Bank of England to satisfy the needs of a smaller population and incomparably smaller international financial responsibilities, the French Conversion Scheme was only accomplished on a 4½ per cent basis, or 1 per cent higher than the British. Not only so, when the French Conversion Loan came on the Paris Bourse it rapidly fell to a discount, whereas the British Conversion Loan commanded a premium on the London Stock Exchange. The transforming effect of the Conversion success upon prices of British Empire Securities is best indicated by a few comparisons—

STOCK EXCHANGE QUOTATION

31st December

	1932	1931	1930
2½ Consols	74¼	55⅜	57¾
4% Funding Loan	108⅞	84	94⅞
3% Local Loans	87¼	61⅛	67¾
Bank of England	323	237½	266½
India 4½%	107¼	69½	87
Canada 4%	103½	82	94½
New Zealand 3½%	97½	74	88½
South Africa 5%	108	91	102

Other stocks and shares, the interest or dividend on which was well secured, shared in the upward movement.

The shares of gold mining companies had risen sharply during the latter part of 1931, because the depreciation in terms of gold of Britain's £ and of certain other nations' currencies meant a rise in the value of the metal as expressed in the frankly inconvertible paper money of those countries. The presence of this premium stimulated production with the result that profits of South

African mines during 1932 were the highest in their history, a fact which brought about a further rise in the prices of shares of gold mining companies.

Sir Alfred Mond

We have seen that round about 1920 amalgamating joint stock companies was the hobby of financiers, many of whom were of capacity unequal to what they were attempting, while some had no clear conception of what they wanted to do. The shadows had closed for some years over these curious efforts before the broken threads of the amalgamation movement in British industry were gathered up into strong and skilful hands. It was in January, 1927, that four great enterprises, the British Dyestuffs Corporation, Brunner, Mond and Company, Nobel Industries, and the United Alkali Company were gathered together under the title of the Imperial Chemical Industries. The person responsible for this merger was Sir Alfred Mond, who later became Lord Melchett and who died in January, 1931. In Sir Alfred Mond were combined several of the most striking features of the Jewish race at its highest point of development. He had a tenacious grip of the first principles of sound finance and industrial organization, and his mind was active with a creative energy akin to that of the truly inspired artist, but unlike the artist Lord Melchett's powers were expressed in the office, the factory, and the market-place. Lord Melchett above all was a practical idealist; he believed that science could be used to improve the lot of mankind almost beyond recognition, and he believed also that large industrial units offered the best means of raising the standard of living of the workers. Indeed, he conceived of industry as a form of communal as well as of working association.

The Scientific Organization of Industry

Obviously, amalgamation carried out under the auspices of one so exceptionally qualified and who had a conviction that this was his mission in life bears no comparison with the feeble rearrangements on paper of companies' fortunes by financial *dilettanti* or mere profit-seekers. Lord Melchett held, as did a Committee of the League of Nations in the same year as the Imperial Chemical Industries was formed, that unregulated competition does not serve the best ends of human society. He enumerated the main essentials of modern industry as firstly, rationalization or the scientific organization of industry in the widest sense; secondly, amalgamations within industries "which are simply a prominent facet of rationalization generally"; thirdly, co-ordination internationally, and, lastly, the closer association of industry and finance.

The possible implications and ramifications of rationalization are manifold; it is a movement finding expression in industries of many countries and probably is destined to be universal in scope. We cannot deal with the matter in all of its aspects, but we may note that as far as amalgamations are concerned, there are two schools of thought, one advocating the merging only of industries engaged in similar pursuits, the other favouring the merging of all industries which have a contact, whether the contact be slight or great, and also of the companies' distributive agencies. Division upon this matter has been most marked in the English textile industry, where the traditional belief in the old forms of individualism is strong and the desirability of industrial change more a subject for dialectic than for action.

An Amalgamation Danger

One of the great dangers of the amalgamation movement is over-capitalization of the resulting entity. Naturally,

the directors of companies to be absorbed secure the best terms possible for the purchase of their concerns; in addition to this the sudden onset of a lengthy trade depression may make companies' earnings for some years prior to amalgamation an unjustifiable standard of valuation. With regard to the valuation of assets, that is a matter for experts. Notoriously, experts differ and Time has a knack of making many of them look extremely foolish. One of the most striking instances of over-capitalization of this kind, which occurred despite careful preliminary investigations by highly qualified accountants, was furnished by the union of the Marconi wireless companies with the cable companies, under the title of Cables and Wireless. The three classes of this combine were dealt in at the time of the introduction to the Stock Exchange in July, 1929, at 96 for the 5½ per cent Cumulative Preference, 90 for the 7½ non-Cumulative "A," and 100 for the "B" Ordinary; in less than eighteen months the prices had touched respectively 9¼, 5, and 40½. It is true that no share at this time, whether of an amalgamated concern or not, was immune from severe depreciation. But an examination of the facts discloses that the fall in Cables and Wireless was only partly attributable to a general tendency and to an error of judgment by dealers when making the first market in the securities; the root of the fall is to be found in a mistaken opinion of the value in the immediate future of the assets acquired by the combination.

Imperial Chemical Industries

Over-capitalization was not a weakness of the Imperial Chemical Industries, although some people, basing their opinion on the size of the capital of the company, concluded that such must be the case. The initial capital was slightly over £58 millions; the Company earned in the first year

of its operations a gross profit of £4,567,000, and was able to pay 7 per cent on its £16 millions of Preference Capital, 8 per cent on its Ordinary Capital of £32 millions, and 1¾ per cent on the £9½ millions of Deferred Capital. By the end of May, 1928, the number of companies actually controlled by the Imperial Chemical had risen to forty and a large degree of control had been acquired over more than thirty others. These companies were engaged in the manufacture of heavy chemicals, explosives, fertilizers, leather-cloth, various non-ferrous metals and alloys, motor-cycles, gas mantles, cellulose finishes, paints, and many other articles. It had subsidiaries in Australia, Canada, South Africa, and South America, and interests in several United States Companies, including the Allied Chemical Corporation, the General Motors Corporation, and the Du Pont Nemours Corporation, the latter itself controlling a number of concerns. At this time the Imperial Chemical employed 44,000 workers who held 653,000 of the Company's Ordinary Shares, while all classes of shareholders totalled over 100,000.

Its Results and Balance Sheet

The Imperial Chemical also formed in May, 1928, in conjunction with the Chase Securities Corporation of America, the Finance Company of Great Britain and America, the nominal capital of which was £2,040,000. It was officially explained that this Company was to provide facilities for commercial and industrial financing in the British Empire, Europe, and the United States, and would develop contracts for the purpose of international industrial development. "There had always been considerable difficulty in British industrial life in getting capital for new enterprises, which at the start had nothing to show. The Company would help such enterprises with capital and advice. The advantage of the Company to investors,

who had no means of testing the value of an enterprise beyond what they could gather from a prospectus was that they would be provided with sound guidance from experts possessed of the necessary knowledge and experience." The first duty of the Company, however, was to underwrite a new issue of capital on the part of the Imperial Chemical Industries. "Your Board," said the Chairman of this latter concern at the meeting in May, 1928, "have decided to ask the shareholders' permission to increase the authorized capital of the Company by the very moderate amount of £10 millions." "I observe with some astonishment," continued Lord Melchett, "that these proposals to increase the capital of the Company appear to be regarded in some quarters as detrimental to the interests of the existing shareholders. I entirely fail to understand the mentality of those who do not realize that increases of capital are a sign of progressive business, and I hope I shall never be connected with any company whose capital account is closed." Some qualification is perhaps needed of the foregoing remarks; certainly, increases of capital should be a sign of progressive business; but they can also be symptoms of over-reaching or of rather desperate attempts to secure new remunerative assets to offset diminishing returns from assets of waning value. However, as far as the Imperial Chemical is concerned,

IMPERIAL CHEMICAL INDUSTRIES—FINANCIAL RESULTS 1927–1932

	1927	1928	1929	1930	1931	1932
	£	£	£	£	£	£
Gross Income	4,567,000	5,997,000	6,502,000	5,129,000	4,668,000	6,415,000
Income Tax	125,000	275,000	146,000	156,000	260,000	686,000
Central Obsolescence Fund	*	500,000	575,000	500,000	1,000,000	1,000,000
Net Profit	4,442,000	5,222,000	5,781,000	4,473,000	3,408,000	4,729,000
Pref. Divd. %	7	7	7	7	7	7
Ord. ,, %	8	8	8	6	4½	6
Deferred Divd. %	1⅞	1⅞	2	nil	nil	nil

* In this year the companies amalgamated made their own provision for obsolescence.

measured by the first six years of the Company's history, there can be no doubt that its first Chairman's policy was justified. The Imperial Chemical Industries was formed barely two years before the occurrence of a world-wide financial and commercial crisis which brought all nations to the verge of bankruptcy. How well the Imperial Chemical withstood that crisis is shown by the comparison given on page 199.

As far as the absence of dividend on the Deferred for the three years to 1932 is concerned it must be understood that Deferred Shares formed only part compensation for shareholdings acquired in other companies. Shareholders in Brunner, Mond and Company, Ltd., for example, received in exchange for each four 7½ per cent Cumulative Preference Shares and each two Ordinary Shares in their own company, five 7 per cent Cumulative Preference, three Ordinary, and two Deferred Shares in the Imperial Chemical. It seems to be desirable before we proceed to discuss other examples of rationalization to reproduce a Balance Sheet and Profit and Loss Statement of the Imperial Chemical, as indicating the manner in which financial information is presented to shareholders by the largest British joint stock concern.

On Consolidated Balance Sheets

The complaint usually made against the published yearly accounts of the Imperial Chemical is that no consolidated Balance Sheet is issued embodying the assets and liabilities of various subsidiaries. It may be doubted whether this is as serious a defect as is commonly supposed. The directors state that the profits of the subsidiaries have been included in the accounts to the extent which they have been declared as dividends, and that the balance of profits carried forward in the accounts of the subsidiaries is in excess of the aggregate losses of the other subsidiaries.

IMPERIAL CHEMICAL INDUSTRIES, LIMITED
ACCOUNTS FOR THE YEAR 1932

Appropriation Account

	£	£	£
Balance brought forward from 1931			516,825
Gross Income for the year to 31st December, 1932—			
Dividends from Subsidiary and Associated Companies	6,012,293		
Income from Investments	403,130		
		6,415,423	
Transfer to Central Obsolescence and Depreciation Fund	1,000,000		
Provision for Income Tax	686,351		
		1,686,351	
			4,729,072
Balance available which the Directors recommend be appropriated as follows—			5,245,897
Allocation to General Reserve		500,000	
PREFERENCE SHARES—			
At the rate of 7% per annum—			
For the half-year ended 30th June, 1932, paid 1st August, 1932	792,571		
For the half-year ended 31st December, 1932, paid 1st February, 1933	794,180		
		1,586,751	
ORDINARY SHARES—			
At the rate of 2½% per annum, paid 1st December, 1932	1,089,740		
At the rate of 3½% per annum, to be paid on 1st June, 1933	1,525,636		
		2,615,376	
			4,702,127
Balance carried forward to 1933			£543,770

Reserve Accounts

	£	£	£
After making the appropriation stated, the Reserve Accounts at 31st December, 1932, stand as follows—			
CENTRAL OBSOLESCENCE AND DEPRECIATION FUND—			
As at 31st December, 1931	5,662,404		
Amount transferred from Capital Reserve (see below)	1,000,000		
		6,662,404	
Less Amounts written off—			
"Shares and Debentures in and Advances to Subsidiary Companies"	3,517,404		
"Land, Buildings, etc."	145,000		
		3,662,404	
		3,000,000	
Appropriated out of 1932 Income		1,000,000	
			4,000,000
GENERAL RESERVE—			
(*a*) Capital Reserve—			
As at 31st December, 1931	8,225,000		
Less Amount transferred to Central Obsolescence and Depreciation Fund	1,000,000		
		7,225,000	
Amounts written off—			
"Shares and Debentures in and Advances to Subsidiary Companies"	418,271		
"Shares and Debentures in Associated Companies"	250,037		
"Marketable and Other Investments"	56,692		
		725,000	
		6,500,000	
(*b*) Free Reserve—			
As at 31st December, 1931	2,500,000		
Appropriated out of 1932 Income	500,000		
		3,000,000	
			9,500,000
			£13,500,000

NOTE. All the dividends have been or will be paid subject to deduction of Income Tax. The final dividend will be payable on 1st June, 1933, to members on the Register of Members on 13th April, 1933.

Profit and Loss Account for the Year Ended 31st December, 1932

	£	£	£
Interim Dividends paid for 1932			1,882,311
Provision for Final Dividends for 1932			2,319,816
Directors' Remuneration (pursuant to Section 128 of the Companies Act, 1929)		45,458	
Less Chargeable to Subsidiary Companies		45,458	
Balance carried forward to 1933, as shown in the Balance Sheet			543,770
			£4,745,897

	£	£	£
Balance brought forward from 1931		516,825	
Dividends from Subsidiary Companies (declared out of Profits for 1932 arrived at, in the majority of cases, before providing obsolescence and depreciation on fixed assets), dividends from Associated Companies, and Income from Investments for the year 1932		6,415,423	
		6,932,248	
Deduct Transfer to Central Obsolescence and Depreciation Fund	1,000,000		
Transfer to General Reserve	500,000		
Provision for Income Tax	686,351		
		2,186,351	
			4,745,897
			£4,745,897

IMPERIAL CHEMICAL INDUSTRIES, LTD.

Balance Sheet as at 31st December, 1932

	£	£ s.	£
Authorized Capital—			
7% Cumulative Preference Shares of £1 each	22,695,000		
Ordinary Shares of £1 each	43,707,355		
Deferred Shares of 10s. each	10,872,645		
Unclassified Shares of £1 each	15,225,000		
Unclassified Shares of 10s. each	2,500,000		
	£95,000,000		
Issued Capital—			
22,690,448 7% Cumulative Preference Shares of £1 each		22,690,448	
43,589,605 Ordinary Shares of £1 each		43,589,605	
21,736,561 Deferred Shares of 10s. each		10,868,280 10	
			77,148,334
Central Obsolescence and Depreciation Fund			4,000,000
General Reserve—			
Capital Reserve		6,500,000	
Free Reserve		3,000,000	
			9,500,000
Note. The details of the Central Obsolescence and Depreciation Fund and General Reserve are shown on preceding page (17 of Annual Report).			
Sundry Creditors and Provision for Taxation and Contingencies			3,307,572
Final Dividends (Gross) in respect of the year 1932, recommended for distribution			2,319,816
Profit and Loss Account: Balance carried forward to 1933			543,770
			£96,819,492

Note *A*. These Investments have been taken at cost or as revalued on the basis of earning capacity on the liquidation of Nobel Industries, Ltd. in 1928, less amounts written off.

Note *B*. There is a depreciation of £3,940,278 in the marketable and other investments to which reference is made in the Directors' Report.

Note *C*. Contingent liabilities existed at 31st December, 1932, in connection with subsidiary or associated companies, viz. (*a*) offers to purchase shares for cash or for share capital; (*b*) guarantees of bank overdrafts; (*c*) guarantees of Debentures; (*d*) guarantee of dividend on preference capital; (*e*) uncalled capital; (*f*) in connection with a guarantee relating to the Company's Pension Funds.

	£	£	£
Shares and Debentures in Subsidiary Companies (See Note *A*)—			
Shares	61,664,191		
Debentures	76,194		
		61,740,385	
Advances to Subsidiary Companies for Capital Expenditure and General Development (*less* amounts written off)		20,209,822	
		81,950,207	
Less Amounts written off in 1932	3,517,404		
Ditto ditto	418,271		
		3,935,675	
		78,014,532	
Less Debts due to Subsidiary Companies		11,706,393	
			66,308,139
Shares and Debentures in Associated Companies (See Note *A*)—			
Shares	6,437,185		
Debentures	14,547		
		6,451,732	
Less Amounts written off in 1932		250,037	
			6,201,695
Marketable and other Investments (See Note *B*)—			
Marketable Shares	7,208,940		
Marketable Debentures	808,236		
		8,017,176	
Unquoted Shares	836,281		
Unquoted Debentures	61,365		
		897,646	
		8,914,822	
Less Loss on Realization of Unquoted Shares and Debentures written off in 1932		56,692	
			8,858,130
Sundry Debtors, Bills Receivable, Loans and Payments in Advance (*Less* Reserves) including Income Tax recoverable from final dividends			3,857,392
Dividends (*less* Tax) included in Profit and Loss Account, to be received from Subsidiary Companies in respect of 1932			4,126,661
Loans To Trustees of Employees' Share Investment Scheme		32,100	
To Officers under Company's Housing Scheme		9,741	
			41,841
Land, Buildings, Magazines, Office Furniture and Fittings, etc. (at cost *less* amounts written off)		483,895	
Less Amounts written off in 1932		145,000	
			338,895
Patents and Trade Marks (at cost *less* amounts written off)			10,470
Cash at Bankers, in Hand, and Invested in British Government Securities—			
Cash		3,523,594	
Government Securities at cost *less* Reserve		3,552,675	
			7,076,269
			£96,819,492

H. McGowan, Reading } *Directors.*

P. C. Dickens, *Treasurer.*

Auditors' Report

We report to the Members of Imperial Chemical Industries, Limited, that we have examined the above Balance Sheet, and that we have obtained all the information and explanations we have required. In our opinion the Balance Sheet referred to, together with the notes thereon, is properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs at 31st December, 1932, according to the best of our information and the explanations given to us, and as shown by the books of the Company.

London, *17th March*, 1933.

Price, Waterhouse & Co., Thomson McLintock & Co. } *Auditors.*

This may seem laconic, but in much the same way as one appraises a mosaic by the whole and not by the pieces, so possibly this is the right attitude to adopt toward concerns such as the Imperial Chemical, whose concentrated result we may accept as an indication of the general state of the various units.

Certainly, another interesting example of rationalization in practice, Unilever, Ltd., which at 31st December, 1932, had an issued capital of nearly £31 millions, does not publish a consolidated Balance Sheet. Presumably, Unilever's audit department has a close grip on the financial position of every company controlled; nevertheless, the task of issuing a consolidated Balance Sheet showing the financial position at a very recent date of 140 companies would be no light undertaking, especially as the companies include Belgian, Dutch, Scandinavian, Swiss, and other foreign concerns. It was formerly often contended by critics that great combines would bring about their own downfall from the alleged reason that they were too big to be managed. These criticisms have become less repeated as it has become understood that the picture of a few directors burdened down with a weight of detail has little correspondence with reality. The great combines are strictly departmentalized, those responsible for the departments reporting to a general executive.

Turner and Newall

Rationalization has made such headway in British industry that it would be possible to cite many examples of this form of industrial and financial evolution. The Royal Dutch group of petroleum companies has a larger combined capital than the Unilever, but the group represents more an interlocking of companies than absolute unitary control, although the establishment of a common policy by the Royal Dutch is equally effective. A much

smaller yet very interesting example is furnished by Turner and Newall, manufacturers of asbestos and allied products. The directors of this concern have stated their conception of rationalization very clearly; their aims are worth reproducing at length. "The Turner and Newall organization," says this statement,

> "is built around the principle of a grouping by consent of allied interests and activities, based upon self-operating units (i.e. branch or controlled companies, each with its own Board of Directors, composed of men actually engaged and experienced in the business) linked up for purposes of co-operation and co-ordination through Executives of Branch and Controlled Company Directors with the Board of your Company, which confines its attention to general matters such as finance and policy. The advantages of this method of co-operative working will be obvious. Firstly, the pooling of knowledge and a general increase in achievement resulting therefrom; secondly, freedom and flexibility at the Branches and Controlled Companies; thirdly, co-operation and co-ordination of effort by means of monthly meetings of Directors and Controlled Companies; and fourthly, a general supervision and control from your own Board with the minimum of interference."

This Company has formed a Cartel to supplement its policy of rationalization through direct control; to this Cartel asbestos manufacturers in ten European countries have so far allied themselves. The objects of the Cartel include exchange of technical knowledge, the establishment in Switzerland of a Central Institute of Research, the foundation of new factories in neutral countries, and the organization of export business. The number of subsidiary companies of Turner and Newall in June, 1933, totalled 27, the control extending to companies producing the raw material as well as to those engaged in manufacturing.

Kreuger and Toll and the Swedish Match

Before we proceed to a few concluding remarks on the subject of rationalization in general, a reference must be made to the activities of the Swedish Companies, Kreuger and Toll and the Swedish Match Company, which have been worked under single control. Readers will remember that we are writing in 1933. Kreuger and Toll is in a sense an Investment Trust Company, but it has been more significantly a Finance Company engaged very largely in smoothing the path for deals by the Swedish Match concern. The policy of the Swedish Match Company has been to acquire in many nations monopolies for the manufacture of matches. It has done so by obtaining control of other concerns, by making working arrangements with other manufacturers to such an extent as to eliminate any real competitive factor, or by securing monopolies direct from Governments in return for loans. Such a loan policy has been carried out almost the world over, and in the carrying out of the policy Kreuger and Toll has played a prominent negotiatory part. The complete control of these two companies until 1932 was in the hands of one, Mr. Ivar Kreuger, who in that year committed suicide, after having brought the concerns over which he was the president into desperate financial condition. Since the direction of Kreuger and Toll and the Swedish Match Company proved to be so seriously at fault, it would be wasting time to attempt to judge the merits and demerits of rationalization from the experiences of these two concerns. We would remark, however, that the granting of loans to impecunious Governments in return for industrial privileges strikes us as a distinctly unhealthy form of capitalistic activity. This form of lending releases Governments from the necessity of having to submit to the ordinary tests of the international capital markets when they want to borrow, and it encourages Governments to run further

into debt than canons of sound finance warrant. Additionally it is unfair to those manufacturers who have not similar resources and to those who, if they had the means, would not deem financing Governments the legitimate concern of industrialists, whether those industrialists acted directly or through a sister Company.

RATIONALIZATION: STATE POLICY AND SOCIAL JUSTICE

The right connection of Governments with rationalization is the other way round, namely, that Governments should foster the movement even to the extent of risking a limited amount of cash where initial guarantees are required, as, for example, in the cases of industries with a future but which have sunk so low that additional capital cannot be obtained without State sponsorship. Even a course such as this should be taken rarely. The better way is on the lines of the Bankers' Industrial Development Company, which was formed in 1930 with a nominal capital of £6 millions, divided into forty-five "A" Shares and fifteen "B" Shares of £100,000 each, one-fourth of the capital being called up. The "A" Shares have been subscribed by British banking and issuing houses, and the "B" Shares by the Securities Management Trust, a company formed by the Bank of England; as the "B" Shares have three times the voting power of the "A," the voting power of the Bank of England is equal to that of the other subscribers.

It was officially stated that the Bankers' Industrial Development Company would examine schemes of rationalization submitted by basic industries and assist those industries to obtain the necessary capital. Individual companies would not be financed; these would still have to negotiate with financial institutions in the ordinary way. The purpose of the Bankers' Company was to ensure

that satisfactory regional schemes for the reorganization of industry would receive the widest measure of practical assistance. It was considered that the approval of the Company would afford evidence that schemes were worthy of support and thus command the backing of City financial houses. The Company during the first four years of its history was principally concerned with attempts to reorganize the Lancashire Cotton Industry, the Lancashire Steel Industry, and the Nottingham collieries. In this period also was formed the National Shipbuilders Security for the buying up and closing down of redundant shipyards, the Securities Management Trust assisting the venture.

Rationalization is at an early stage; many of the changes it is likely to induce are the province of the engineer, and upon most of the lines of possible development, industrial or financial, it would be rash to prophesy. The investor would do well to bear in mind, however, that the relation of the large combination to the State and to the public will be an increasingly responsible one. Dividends are unlikely to be paid on the scale which swelled the stomachs and turned the heads of the most materially favoured of our Victorian ancestors. Some of us who are investors and who want to see the cause of social justice advance will not repine; and neither will we buy the shares of rationalized concerns at prices which suggest that distributable profits will be unlimited.

NOTES

CHAPTER I. I am aware that there are aspects of the controversy upon usury specially appealing to philosophers and theologians and that the attitude of the Church toward the taking of interest may have been more fundamental than secularly-minded historians allow and a majority of the Church's pamphleteers reveal. A particularly sympathetic examination of the Church's case is to be found in Mr. R. H. Tawney's introduction to *A Discourse upon Usury* by Thomas Wilson. "The formal expression of medieval theory retained to the end," says Mr. Tawney, "the characteristics natural in a system which claimed to mediate between the humblest activity and the divine purpose and which, therefore, discussed economic issues as subordinate to the real business of life, which is salvation. It was the menace to this whole philosophy which causes contemporary religious opinion to find an almost tragic interest in the controversy with regard to usury. For it had been through the theory of usury that the most persistent attempt had been made to translate these general ethical conceptions into a legal system applicable to the particular transactions by which property is acquired and trade carried on."

George Eliot, presumably relying on Italian historical sources, tells us in the fifth chapter of *Romola* that the Bardi, "the Christian Rothschilds of that time," undertook to furnish specie for the wars of Edward III and had revenues in kind made over to them, especially in wool. "Their august debtor left them with an august deficit, and alarmed Sicilian creditors made a too sudden demand for the payment of their deposits, causing a ruinous shock to the credit of the Bardi and that of associated houses, which was felt as a commercial calamity along the coasts of the Mediterranean." Actually, the Bardi failed in the reign of Henry VI, nearly seventy years after the death of Edward III. Therefore, the failure can hardly be attributed to the misdoings of the latter monarch.

CHAPTER II. The Merchants of the Staple and the Brotherhood of St. Thomas à Becket, which in some old references seem indistinguishable from one another, were in existence before the Society of Merchant Adventurers. The date of the Staplers' first English Charter is unknown, but it is recorded that they were trading to the Netherlands in the middle of the thirteenth century. It is noteworthy that the Staplers were for long all foreigners and that this state of affairs was

encouraged by English kings. The Staplers can be regarded as an English Corporate Body from 1362, when restrictions on English merchants were removed. The Society of Merchant Adventurers claim to have sprung from the London Guild of Mercers, a Company which started the first woollen manufacture in England in 1296.

The Levant Company in 1680 claimed to be Regulated, and in the course of a dispute with the East India Company criticized joint stock companies as not so much encouraging merchants as all sorts and conditions of people who happened to be shareholders. It might seem to follow that at this time only actual merchants were shareholders in the Levant Company. But in 1629 the Levant Company resolved to trade as joint stock, so as to reduce the Greeks to reasonable prices. The joint stock principle was re-affirmed in the following January, as likely to be beneficial to the Company.

CHAPTER III. Charles I's dislike of the East India Company is the better understood when it is known that the Company declined to advance him money or to allow him to join the Company without paying his footing.

CHAPTER VII. "The last twenty years of the eighteenth century yield us little in company history." Yield us little, that is, as far as the main stream of company history is concerned. Between 1780 and 1790 several substantially capitalized companies were formed in the provinces, including the Cornish Metal Society, the Birmingham Mining and Copper Company, and the Crown Copper Company. The capital, however, was subscribed locally and the number of shareholders small.

CHAPTER VIII. Britain's Foreign Investments. Professor J. H. Clapham refers to a "reputed" amount of £93 millions in 1827. (*An Economic History of Modern Britain*, 1926 Edition, page 495.)

"The amount of British investments in the United States round about 1840 has been estimated at figures varying from £22 millions to £40 millions." The first estimate is that of Garland; the second that of Andrew Jackson.

" . . . the figure of £224 millions looks below the mark, at least as far as investments in Railway Companies are concerned." Leone Levi in *The History of British Commerce* gives £69,626,000 as the nominal capital of Railway Companies making public issues in 1834, 1835, and 1836. The total capital of British Railways at 30th June, 1845, was £88,481,000.

CHAPTER IX. "There is fairly definite evidence that twenty-five years later the sum was approximately £1,000

millions." I have accepted Sir Robert Giffen's estimate of £1,300 millions as the amount of British capital invested abroad at the end of 1878. If we take the average annual amount of overseas investment from 1871 to 1878 at £35 millions we are left with a total of £1,000 millions as the figure at the end of 1870.

"The amount of gold currency in circulation within the United Kingdom increased from £1 13s. per head of population in 1844 to £2 12s. per head in 1868." The estimate for 1844 is based on William Newmarch; that for 1868 on W. S. Jevons.

CHAPTER XII. Classification of Investments. The example is from the Report of the Lake View Investment Trust for the year to 31st March, 1933. It will be appreciated that the method of distribution of investments varies greatly according to the convictions, knowledge, and temperament of directors.

The quotation from Mr. Glasgow is from his book *The Scottish Investment Trust Companies.*

CHAPTER XVII. Britain's Overseas Investments. Sir Robert Kindersley in 1933 estimated Great Britain's Overseas Investments at 31st December, 1930, as amounting to £3,185 millions. This figure represents public issues of capital only and does not include private investments and securities not quoted in Great Britain, which would, Sir Robert calculates, account for another £540 millions. Sir Robert "roughly" estimates that these £540 millions were distributed as follows: Dominions, £200 millions; United States, £120 millions; South America, £120 millions; and Europe, £50 millions. His analysis of the geographical distribution of the public issues is set out below—

	£		£
Australasia	494,000,000	Europe	245,000,000
India and Ceylon	458,000,000	Argentine	360,000,000
Canada	446,000,000	Brazil	151,000,000
South Africa	224,000,000	Chile	49,000,000
New Zealand	123,000,000	Rest of South America	83,000,000
Malaya	108,000,000	Mexico and Central America	50,000,000
British West Africa	46,000,000	United States	81,000,000
West Indies	40,000,000	Japan	63,000,000
Other Colonies	48,000,000	China	40,000,000
		Other Asiatic Countries	47,000,000
		Non-British Africa	29,000,000
Total Dominions	£1,987,000,000	Total Foreign Countries	£1,198,000,000
Grand Total	£3,185,000,000		

Sir Robert put the income from British Overseas Investments in the four years 1929–32 as under—

	1929	1930	1931	1932
From	£	£	£	£
Foreign and Colonial Governments and Municipalities . . .	64,661,000	64,666,000	65,920,000	60,000,000
British Companies (registered in Great Britain) .	85,983,000	76,466,000	48,747,000	42,500,000
Foreign and Colonial Companies (registered abroad) . . .	61,721,000	51,043,000	40,846,000	38,200,000
Other Investments not covered by above .	18,510,000	16,830,000	13,224,000	11,900,000
	£230,875,000	£209,005,000	£168,737,000	£152,600,000

It will be noted that Great Britain's investments in the United States at 31st December, 1930, were substantially less than at the end of 1913, reflecting the vast sales of these investments made by Great Britain in order to finance the War.

CHAPTER XVIII. "A League of Nations Report"—The Course and Phases of the World Economic Depression.

CHAPTER XIX. Imperial Chemical Industries. "The initial capital was slightly over £58 millions." Some industrious person is sure to add up the shares enumerated and find that the total is £57½ millions. Therefore, I explain that another £500,000 had been allotted, but did not rank for dividend in the first year.

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